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REPORT

TO THE

FINANCE COMMITTEE

OF THE

BOARD OF SUPERVISORS

REVIEW OF THE OPERATIONS OF THE EMPLOYEES RETIREMENT SYSTEM CITY AND COUNTY OF SAN FRANCISCO

BUREAU OF THE BUDGET

BOARD OF SUPERVISORS

FEBRUARY 1977

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CITY AND COUNTY OF SAN FRANCISCO

BOARD OF SUPERVISORS
BUREAU OF THE BUDGET

CITY HALL, SAN FRANCISCO 94102 • TELEPHONE 558-2641

February 22, 1977

Honorable John J. Barbagelata
Chairman, and Members of the Finance Committee
Board of Supervisors
Room 235, City Hall
San Francisco, California 94102

Dear Mr. Chairman and Members:

Transmitted herewith is our management audit report on the operations of the San Francisco Employees Retirement System. The Retirement System General Manager, responsible for the day-to-day administration of the Retirement System, reports to a 7-member Retirement Board. The General Manager and his staff fully cooperated with our audit efforts.

The Employees Retirement System has the responsibility for managing the retirement programs which have been established for City and County employees including determining the annual contributions which are necessary to maintain the Retirement Fund, investing the monies in the retirement fund, and administering the benefits provided under Workers Compensation laws. As of June 30, 1976, there were approximately 33,600 members in the Retirement System and the Retirement Fund contained assets of over $700 million. In 1976-77, the estimated annual cost to the City and County for its contribution to the Retirement System is $88 million.

The Employees Retirement System should be commended for maintaining a retirement program which is one of the most soundly funded retirement systems in the nation. However, despite this accomplishment, our review has identified various deficiencies, including estimated lost investment revenues and unnecessary expenditures of over $3.2 million annually. Further, we project that the City and County

could save approximately $148 million over the next 21 years by withdrawing from the Social Security System and establishing supplemental retirement benefits in lieu of social security for existing employees. To achieve these savings, a one-time net loss of $2.6 million would be incurred.

Our report has cited the following deficiencies:

- The Employees Retirement System has maintained $156.4 million of prior years' lower yielding bond investments with yields as low as 2-3/4%. As a result of declining to sell such bonds at a loss and reinvesting the proceeds in higher yielding bonds averaging an 8.93% return in 1975-76, annual investment income of approximately $2.3 million was lost. The following examples evidence lost annual interest income resulting from the System's policy of maintaining lower yielding bonds:

Bond	Coupon Rate	Lost Annual Interest Income Exclusive of One-Time Capital Loss
Duquesne Light	2-3/4	$ 5,834
Louis G & E	2-3/4	16,094
Ill. Bell Tel.	3	42,151
Proct. & Gamble	3-7/8	31,223
AT & T	3-7/8	22,867
US Treasury	4-1/4	93,852
Cont. Oil	4-1/2	21,457
Shell Oil	4-5/8	24,561
Sun Oil	4-5/8	20,390
SW Bell	5-3/8	24,769

Including a one-time loss of $8 million which would have resulted from the sale of the $156.4 million of the bonds in question, the Retirement System would have realized a net increase in investment income of $38.3 million by the year 2014, the last year in which the lower yielding bonds mature.

The Retirement System itself has implemented a policy of selling some of its lower yielding bonds, but such sales have averaged only $12.8 million annually over the past 2½ years or $143.6 million less than what could have been sold in 1975-76. Reinvestment of the proceeds from the lower yielding bonds into higher yielding bonds of quality, maturity, industry mix and call protection similar to the System's $50.2 million of bond purchases in 1975-76 would achieve our objective.

- The Employees Retirement System had 23.7% of its total investments in common stock as of 6/30/76 or over 3% in excess of the 20.5% average of 18 other public retirement systems in California. Based on the average yield of 8.93% in 1975-76 on its long-term bond purchases, versus the System's yield on common stocks of 3.2%, the yield on bonds significantly exceeded the yield on stocks. By not having limited its stock investments to about 20% of its total investment portfolio and correspondingly increased its investments in long-term bonds, the Retirement System lost additional investment income of $1.4 million in 1975-76.

- The Employees Retirement System maintained over $21 million on an average daily basis in lower yielding short-term commercial paper. Over $16 million of such funds could have been invested in higher yielding long-term bonds. As a result, interest income of approximately $450,000 annually was lost.

- The Employees Retirement System has maintained excessive cash balances of about $7 million daily with the Treasurer's Office. As a result of the Treasurer's restricted lower yielding investments, which had an average yield of 6.12% in 1975-76 as compared to the Retirement System's yield on long-term bond purchases of 8.93%, earnings of approximately $196,000 were lost in 1975-76.

- The methods used by the Employees Retirement System for estimating the City and County's contributions to the retirement fund are inadequate. As a result, we estimate that the Retirement Fund loses the use of $20.3 million. While such funds are maintained in the Treasurer's Office, as previously noted, the Retirement System can earn nearly 3% more than the Treasurer. Improved estimating techniques would result in a one-time increase of investment revenue of over $570,000.

- In 1975-76, San Francisco had 112 disability retirements of uniformed Police and Fire Department personnel as compared to 67 for the City of Los Angeles even though Los Angeles had nearly 3 times the budgeted positions of San Francisco. For this same year, the rate of such disability retirements for San Francisco was 5 times that of Los Angeles. Most of the problems relating to the disability retirements fall outside of the responsibility of the Retirement System and involve the

Civil Service, Police and Fire Departments. Inconsistently applied medical standards of the Employees Retirement System, Civil Service, Police and Fire Departments, used in the hiring and promoting of Police and Fire Department uniformed personnel, could result in disability retirements for such employees being unnecessarily high. As examples of such inconsistencies, x-ray examinations are given to men but not to women, and electrocardiographic studies are required for new employees but not for employee promotions. Further, records of the Workers Compensation Division of the Employees Retirement System are not routinely provided to Police and Fire Department surgeons for promotional examinations.

- The workload of the Retirement Board is excessive, particularly in the area of disability hearings. While the Board heard and decided 298 disability and other types of cases from January through June, 1976, it is estimated that it will take the Board at least six months to eliminate its backlog of cases without considering the time required for new cases.

- There has been inadequate disclosure in the accounting and budgeting of disability payments which totalled $5.1 million in 1975-76. For example, over $4 million of such payments for Police, Fire and Sheriff's uniformed personnel were expended. However, the funds for such expenditures were budgeted, but not identified, in salary accounts. We recognize that budget presentation is not the responsibility of the Retirement System.

- It is projected that the City and County's contribution for social security, amounting to $12.5 million in 1976-77, will have increased to approximately $43 million by the year 2001. Based on our projections, the City and County's costs for social security will have increased by 3,062% since 1960-61 when the City began its participation in the Social Security program. Although initially for the first 7 years costs would increase by an average of $1.4 million annually, the City and County could save $148 million over a 21-year period by withdrawing from the Social Security System and establishing a Supplemental Retirement System with comparable benefits for existing employees.

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We recommend that the Employees Retirement System:

- Sell the lower yielding bonds listed in Appendix A of our report and reinvest the proceeds in higher yielding bonds.

- Reduce its investment in common stocks from 23.7% to 20% of its total assets and reinvest the proceeds in long-term bonds.

- Reduce its lower yielding short-term investments from over $21 million on an average daily basis to an average daily amount of about $5 million, and invest the difference of over $16 million in higher yielding long-term bonds.

- Discontinue maintaining excessive cash balances with the Treasurer's Office and invest such excess cash in long-term bonds.

- Improve the techniques for estimating the employer contributions to the Retirement Fund in accordance with the recommendations contained on page 26 of our report.

- Consult with the Civil Service Commission and the Police and Fire Departments for the purpose of reviewing and revising the inconsistencies in the medical standards used in the hiring and promoting of Police and Fire Department uniformed personnel, and routinely provide Workers Compensation Division records to Police and Fire Department surgeons prior to promotional examinations.

- Request the Controller to devise a system to ensure that all City and County departments fully disclose the costs of disability payments in budget and expenditure reports in a uniform and consistent manner.

  We recognize that these latter two recommendations fall outside the responsibility of the Retirement System.

We recommend that the Board of Supervisors retain an actuarial firm and professionals in the benefits field to study the potential savings which would result from the withdrawal of the City and County from the Social Security System and the implementation of supplemental retirement benefits in lieu of social security for existing employees. If the results of such a study validate our projected savings, it is recommended that the City and County take the necessary steps to withdraw from the Social Security System.

On November 12, 1976, the President of the Board of Supervisors requested the City Attorney to draft a charter amendment to provide for a hearing officer for disability cases. Our finding is consistent with the President's request. We recommend that the Board of Supervisors submit a charter amendment to the electorate to provide that the determination of eligibility for disability benefit applications be delegated to a professional hearing officer.

Since the yield on long-term bonds purchased during the first half of fiscal year 1976-77 was 8.42%, we have revised our projected savings accordingly. We conservatively estimate, that in addition to various benefits, the implementation of our recommendations will result in increased revenues and reduced expenditures of at least $3.2 million annually. Further a net reduction of social security expenditures of $148 million over a 21-year period could result. As previously noted, to achieve these savings, a one-time net loss of $2.6 million would be incurred. Exclusive of this one-time net loss, these recommendations will directly reduce property taxes.

A written response to our report, received from the Retirement System General Manager, is contained on pages 48 through 93. Based on this response, our report has been revised to correct any errors or statements needing further clarification.

In general the response of both the Employees Retirement System and its investment consultant, Crocker Investment Management Corp. is highly critical of our report. However, aside from our report revisions as noted above, the facts, conclusions, and recommendations contained in our report stand. Detailed working papers, evidencing such facts and supporting our conclusions and recommendations, are available for the review and inspection of all interested parties.

The General Manager's response includes a statement that the adoption of our recommendations by the Board of Supervisors concerning the investment practices of the Retirement System constitutes "...a violation of the provisions of Section 2.401 of the Charter." We clearly stated to the General Manager at our closing audit conference that our report and its recommendations are strictly advisory in nature to the Board of Supervisors.

Respectfully submitted,

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Budget Director and Analyst

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Supervisor Francois
Supervisor Gonzales
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Supervisor Nelder
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INTRODUCTION

In response to a request by the Finance Committee of the Board of Supervisors, the Bureau of the Budget has conducted a management audit of the Employees Retirement System Department. This audit was comprehensive in that all aspects of the Department were surveyed. The primary authority governing the operations of the Employees Retirement System is contained in Sections 8.500 - 8.581 of the Charter of the City and County.

The Employees Retirement System has the responsibility for managing the retirement programs which have been established for employees of the City and County of San Francisco. This responsibility includes determining the annual contributions which are necessary to maintain the retirement fund, processing members and the claims of those members, auditing payroll records of the City and County in order to monitor employee and employer retirement contributions, investing the monies in the retirement fund, adjusting claims and providing benefits under the Workers' Compensation laws as they affect City and County employees, and overall responsibility for administering the retirement system. As of June 30, 1976, there were approximately 33,600 members of the Retirement System and the retirement fund had assets of over $700 million. For 1976-77 the estimated annual cost to the City and County of the employer's contribution to the Retirement System is $88 million.

Appendix I provides an organization chart of the Employees Retirement System. As can be seen from this chart, the Retirement System is administered by a Retirement Board. The Retirement Board consists of seven members: the President of the Board of Supervisors; three active members (City employees) of the Retirement System elected by the members of the System, and three members appointed by the Mayor. The members appointed by the Mayor must either hold a degree of Doctor of Medicine or be experienced in life insurance, actuarial science, employee pension planning, or investment portfolio management. Each member appointed by the Mayor must be selected from a list of names submitted by a committee consisting of two members each of the San Francisco Medical Society, Bar Association, Real Estate Board, and the Chamber of Commerce.

Assisting the Retirement Board are an actuary and a General Manager, both of whom are appointed by the board. The General Manager has a staff of 74 permanent employees as well as 18 employees hired under the Federal Comprehensive Employment and Training Act. These employees are divided into six divisions: Administration, Investment, Accounting, Actuarial, Membership, and Workers Compensation. Additionally, the Retirement System retains outside actuarial and investment consultants on a contractual basis.

The Employees Retirement System has a number of different retirement programs covering different types of employees. These programs differ in terms of benefits provided, employee contribution rates, and contributions that the City and County make to the employers' portion of the retirement fund. The basic types

of employees, for the purposes of the Retirement System, are police, fire, and miscellaneous. The date on which these employees joined the Retirement System affects their benefits and contribution rates.

For City and County employees who join the Retirement System after November 1, 1976, the retirement benefits are as follows: (1) for members of the Police and Fire Departments age 50 with at least 25 years of service, the retirement benefit is 50% of the average of the three highest annual salaries received plus 3% of the three highest annual salaries received for each year of service in excess of 25 years; (2) for miscellaneous employees age 60 with at least 10 years of service the retirement benefit is 1-2/3% of the average of the three highest annual salaries for each year of service up to a maximum of 70% of the average of the three highest annual salaries. For all employees of the City and County who joined the Retirement System before November 1, 1976, retirement benefits are as follows: (1) for employees of the Police and Fire Departments age 50 with 25 years of service the retirement benefit is 55% of the highest salary received plus 4% of the highest salary received for each year of service in excess of 25 years; (2) for miscellaneous employees age 60 with at least 10 years of service the retirement benefit is 2% of the highest annual salary for each year of service up to a maximum of 75% of the highest annual salary. Under these different plans the

retirement benefits available to Police, Fire, and miscellaneous employees with 30 years of service and an average final salary of $15,000 would be as follows:

	Annual Benefit If Joined Retirement System Prior to 11/1/76	Annual Benefit If Joined Retirement System After 11/1/76
Police and Fire	$11,250	$9,750
Miscellaneous	$ 9,000	$7,515

Employee contributions to the retirement fund vary by type of employee and by the date on which the employee joined the Retirement System. For all employees of the City and County who joined the Retirement System before November 1, 1976, the employee's retirement contribution was dependent on the age of the employee at the time he or she joined the Retirement System. Miscellaneous employees paid between 5.97% and 9.81% of their income into the retirement fund while employees of the Police and Fire Departments paid between 6.57% and 7.00% of their incomes into the retirement fund. For all those employees who joined the Retirement System subsequent to November 1, 1976, the percentage of income paid into the retirement fund was fixed by the passage of Proposition "L" in November, 1976, for all age groups and all employee categories at 7.0% of salary plus 0.5% for cost of living adjustments.

The Employees Retirement System operates on a policy of full funding. However, due to improvements in the Retirement benefits which were approved by the voters as charter amendments, the System was approximately 73% funded as of July 1, 1974.

The concept of full funding means that the benefits paid to retirees result from the investment of the contributions paid into the retirement fund by those retirees and the City and County during the time that they were employed. In other words, the retirement contributions of current employees of the City and County are used to fund their own future retirement benefits, not the benefits of previous employees. The employer contribution rates are based on various assumptions regarding the average tenure, life expectancy, future salary levels, projected investment income, etc. for the City and County employees. However, employee contribution rates are fixed in the City and County Charter. Therefore the employer contribution rates for the City and County are adjusted to reflect the changing needs of the retirement fund.

The City and County (employer) contribution to the retirement fund is a percentage of employees' salaries which varies according to the needs of the retirement fund as determined by the Actuarial Division of the Employees Retirement System. Between 1964 and 1977, the employers contribution rates for the three basic types of City and County employees were as follows:

Effective Date	Miscellaneous Employees (%)	Police (%)	Fire (%)
July 1964	5.166%	15.798%	12.791%
July 1969	11.205	27.204	24.498
July 1971	11.502	29.877	25.782
July 1973	12.819	33.188	30.478
July 1974	16.813	33.188	30.478
July 1975	16.239	57.605	45.239
July 1976	18.426	73.90	67.09
Nov. 1976*	14.30	54.45	48.64

*For new employees hired after 11/1/76.

During this period of time, the City and County annual contributions to the Retirement System grew from $14.8 million in 1964-65 to an estimated $88 million in 1976-77.

As can be seen, there have been substantial changes in the Employees Retirement System over the past eight years. These changes have affected benefits and contributions and have resulted primarily from charter amendments approved by the electorate. Major changes in the City and County charter affecting the Retirement System include the passage of Proposition "E" in 1973 increasing retirement benefits for miscellaneous employees, the passage of Proposition "E" in 1974 increasing the retirement benefits for retired miscellaneous employees, the passage of Propositions "H" and "M" in 1975 increasing the retirement benefits for employees of the Police and Fire Departments, and the passage of Proposition "L" in 1976 which reduced the retirement benefits for City and County employees entering the Retirement System after November 1, 1976.

In conducting this management audit, employees and management personnel at all levels within the Department were interviewed. The General Manager and his entire staff cooperated fully. Additionally, employees of the Social Security Administration, various local jurisdictions and several investment firms were interviewed. A survey of 18 public employee retirement systems throughout the State of California was also conducted.

The Retirement System should be commended for maintaining a retirement program which is one of the most soundly funded retirement systems in the nation. Despite this accomplishment, however, various deficiencies as explained in the following pages have been identified during our audit. We estimate that our recommendations with regard to these deficiencies would have generated additional income of $4.3 million annually and a one-time net loss of $2.6 million if investment practices proposed in our recommendation had been followed in 1975-76. These estimates are summarized as follows:

Increases to annual income and reductions in annual expenditures

Reinvest proceeds from sale of lower yield bonds in higher yield bonds	$ 2,300,000
Reduce common stock portfolio and reinvest the proceeds in higher yield bonds	1,400,000
Invest excess cash in higher yield bonds	196,000
Reduce short-term investment portfolio and reinvest the proceeds in higher yield bonds	450,000
Hearing Officer and Related Secretarial Assistance	(52,800)
Total increases	$ 4,293,200

One-time gains (losses)

Sell lower yield bonds at market value	($ 8,000,000)
Reinvest bond sale proceeds in higher yield bonds @ 96.8% of par value	4,900,000
Reduce stock portfolio by selling certain stocks at market value	(600,000)
Reinvest proceeds from stock sales in higher yield bonds @ 96.8% of par value	530,000
Revise the procedures for estimating employer contributions to the retirement fund	570,000
Net losses	(2,600,000)

As can be seen, these recommendations deal principally with revising the investment portfolio of the Retirement System in order to take advantage of the higher yields which were available for bonds during 1975-76. Bonds purchased during 1975-76 provided an average yield of 8.93% and we have used this rate of return to calculate the additional revenue that would have been available to the Retirement System during 1975-76. We recognize, however, that the bond market fluctuates and therefore the dollar amounts that we have calculated may vary somewhat from one year to the next. Further, we recognize that the investment markets can and do change, making it mandatory for the Employees Retirement System to constantly monitor the various investment opportunities available to insure the highest returns to the City and County. However, on the basis of our review, under the present

circumstances, we believe that our recommendations relating to increased emphasis on long-term bonds should be implemented.

The Retirement System estimates for long-term purposes that the average yield from the reinvestment of interest income will be 7%. In the first half of 1976-77, the yield on long-term bonds purchased by the Retirement System was 8.42% rather than the 8.93% on bonds purchased in 1975-76. Based on the 7% reinvestment of interest income and the 8.42% yield on long-term purchases, the recommendations that we have made would produce estimated increased investment income of over $3.2 million annually.

In addition to our investigation of the investment policies and practices of the Retirement System, we also investigated the actual and projected costs of the Social Security System to the City and County. Our findings with regard to this investigation projected that the City and County could save approximately $185,000,000 over the next twenty-one years by withdrawing from the Social Security System and establishing a Supplemental Retirement System for existing employees.

To summarize, the implementation of our recommendations would provide estimated increased revenues of over $3.2 million annually, a one-time loss of $2.6 million, and a reduction in expenditures of approximately $185,000,000 over a 21-year period. Exclusive of the one-time net loss, these recommendations, if implemented, would directly reduce property taxes.

THE EMPLOYEES RETIREMENT SYSTEM HAS MAINTAINED $156.4 MILLION OF PRIOR YEARS' LOWER YIELDING BOND INVESTMENTS WITH YIELDS AS LOW AS 2-3/4%. AS A RESULT OF DECLINING TO SELL SUCH BONDS AT A LOSS AND REINVESTING THE PROCEEDS IN HIGHER YIELDING BONDS AVERAGING AN 8.93% RETURN IN 1975-76, ANNUAL INVESTMENT INCOME OF APPROXIMATELY $2.3 MILLION WAS LOST.

As of June 30, 1976, the entire investment portfolio of the Retirement System had an estimated cost valuation of $687 million. This total was categorized as follows:

Bonds	$489 million	(71%)
Stocks	163 million	(24%)
Convertible Securities	16 million	(2%)
Notes	19 million	(3%)
Total	$687 million	(100%)

The average investment return for the entire portfolio was estimated at 5.3% in 1975-76. Rates of return for the categories of investments listed above were as follows:

Bonds	6.1%
Stocks	3.2
Convertible Securities	5.3
Notes	5.2
Average for entire portfolio	5.3%

As noted above, effective June 30, 1976, the cost value of the Retirement System's bond portfolio was $489 million and the investment income on the entire bond portfolio was 6.1%. For bonds purchased during 1975-76, however, the investment income was 8.93%. The lower rate of return for the entire bond portfolio is due to the fact that many of the bonds purchased prior to 1975-76 provide investment incomes substantially below what was available in the bond market during 1975-76.

At the end of 1975-76, the Retirement System's bond portfolio contained certain bonds with a cost valuation of $156.4 million with some bond yields as low as 2-3/4%. (These bonds are listed in Appendix A) If these bonds had been sold at their market value and the proceeds of

those sales reinvested at the average rate of return (8.93%) for the $50.2 million of bonds purchased by the Retirement System during 1975-76, an additional $2.3 million in investment income could have been realized. The average maturity of 1975-76 bond purchases was about 24 years. Reinvestment of the proceeds from the lower yielding bonds into higher yielding bonds of quality, maturity, industry mix and call protection similar to the System's $50.2 million of bond purchases in 1975-76 would achieve our objective. If such reinvestments had been made, the total additional interest income realized by the equivalent maturity dates of the bonds sold would have been $42.9 million assuming a reinvestment of earnings at 7%.

Examples of bonds currently held in the System yielding lower interest rates, which if sold and reinvested in bonds yielding higher interest rates would generate significantly increased income are as follows:

Maturity Value	Bond	Coupon Rate	Maturity Date	Market Value	Annual Income Current	Annual Income @ 8.93%
$3,000,000	U.S.Treas.	4-1/4	5-15-85	$2,478,750	$127,500	$221,352
1,025,000	Shell Oil	4-5/8	8-1-86	805,906	47,406	71,967
1,125,000	Cont.Oil	4-1/2	5-1-91	807,188	50,625	72,082
1,000,000	Sun Oil	4-5/8	11-15-90	746,250	46,250	66,640
2,300,000	SW Bell	5-3/8	6-1-06	1,661,750	123,625	148,394
$8,450,000				$6,499,844	$395,406	$580,435

In order to sell bonds in the portfolio with relatively low rates of return, they would have to be discounted to their market value. As of June 30, 1976, the market value of the bonds mentioned above was $148.4 million, or $8 million less than their purchase price. Thus selling these bonds and reinvesting the proceeds in higher yielding bonds would require that the Retirement System take an $8 million one-time capital loss in order to realize an increase in investment income of $2.3 million in the first year and equivalent sums compounded in successive years. At the maturity of the new higher yielding bonds, a capital gain of $4.9 million would be realized based on an average price of bonds purchased during 1975-76 at 96.8% of par value. Considering both the one-time loss of $8 million and the one-time gain of

$2.6 million biweekly. As a result of this significant difference, and the 14-month period before it will be recovered, it is estimated that the retirement fund is currently losing the use of $20.3 million.

There are two principal contributing factors to the low estimates of employer contributions:

The first factor is that estimates are made on a monthly basis whereas City and County payrolls are paid on a biweekly basis. Biweekly payrolls mean that two months in any given year have three pay periods while the remaining 10 months have two pay periods. Current monthly estimates of employer contributions made by the Retirement System are based on a month having two pay periods. Consequently, two entire payrolls with employer contributions totalling about $3.3 million each are not included in the estimate of employer contributions to the retirement fund.

The second factor is that the estimates of employer contributions to the retirement fund based on 90% of prior year payrolls as adjusted for wage increases are much lower than 90% of actual employer contributions. Our sample of 1976-77 payrolls indicates that estimates of employer contributions made by the Retirement System are less than 80% of actual employer contributions. This comparison of estimated and actual payments suggests that the present method of estimating employer contributions is not adequate.

Given the current lag between estimates of employer contributions and the time that the actual employer contributions to the Retirement System are known, the Retirement System is able to invest the monthly estimate of employer contributions plus the difference between the estimated and the actual contributions for payrolls occuring fourteen months previously. If the estimates were improved, there would be a period of approximately one year during which the Retirement System would receive the revised estimated employer contributions plus the difference between the estimated employer contribution and the actual employer contributions in the previous year. After approximately one year, however, the difference between the estimated and the actual employer contributions should decrease significantly due to the improved estimates. Thus the additional revenue received by the Retirement System as a result of these changes should be treated as a one-time event rather than an increase that will be available for each successive year.

If estimates of employer contributions were improved, one result would be a quicker transfer of funds from the Treasurer to the Retirement System. This transfer would produce an increased return on the investment of these funds, but the increased return would benefit the Retirement System rather than the general fund of the City and County. However, the increased return would result in reduced employer contributions since additional assets would be made available to the Retirement System for investment. Therefore, the net increased revenues from the higher return would result in a net reduction of ad valorem taxes required by the City and County.

RECOMMENDATIONS*

We recommend that the Employees Retirement System:

- Sell the lower yielding bonds listed in Appendix A and reinvest the proceeds in higher yielding bonds.
- Reduce the System's contingency reserve by $3.8 million.

SAVINGS

Implementation of these recommendations would have resulted in increased investment income of an estimated $2.3 million annually and $42.9 million over the life of the applicable bonds. Further, a one-time capital gain of $4.9 million would have been realized and a one-time capital loss of $8 million would have been incurred.

*The City Attorney's Office advised us that our recommendations would not violate any section of the Charter of the City and County of San Francisco. Regarding our recommendations relating to the contingency reserve, this reserve was established to meet possible deficiencies in interest of future years, losses on investments, and other contingencies. As previously noted, the System must maintain 2% of its assets in this reserve. The Retirement System stated that for actuarial purposes it is required to use the excess funds in the contingency reserve to pay for retirees' cost of living benefits. However, the recommendations contained in our report will result in significant increased investment earnings on an annual basis, and in a little over one year, such increased earnings would replenish the funds which we are recommending to be withdrawn from the contingency reserve.

In fiscal year 1974-75, the Retirement Board decided to take a loss on the sale of stocks and bonds of over $5.7 million which directly resulted in the contingency reserve being reduced in that year by approximately $3.7 million. We conclude that our similar recommendations will improve the financial soundness of the retirement fund.

THE EMPLOYEES RETIREMENT SYSTEM HAD 23.7% OF ITS TOTAL INVESTMENTS IN COMMON STOCK AS OF 6/30/76 OR OVER 3% IN EXCESS OF THE 20.5% AVERAGE OF 18 OTHER CALIFORNIA AGENCIES. BASED ON THE AVERAGE YIELD OF 8.93% IN 1975-76 ON ITS LONG-TERM BOND PURCHASES VERSUS THE SYSTEM'S YIELD ON COMMON STOCK OF ONLY 3.2%, THE YIELD ON BONDS SIGNIFICANTLY EXCEEDED THE YIELD ON STOCKS. BY NOT HAVING LIMITED ITS STOCK INVESTMENTS TO ABOUT 20% OF ITS TOTAL INVESTMENT PORTFOLIO, AND CORRESPONDINGLY INCREASED ITS INVESTMENTS IN LONG-TERM BONDS, THE RETIREMENT SYSTEM LOST ADDITIONAL INVESTMENT INCOME OF $1.4 MILLION IN 1975-76. WHILE A ONE-TIME CAPITAL LOSS OF $600,000 WOULD HAVE BEEN INCURRED, THE INCREASED INCOME OF $1.4 MILLION WOULD BE EARNED ANNUALLY IF THE RETIREMENT SYSTEM REDUCED ITS INVESTMENTS IN COMMON STOCK AND CORRESPONDINGLY INCREASED ITS INVESTMENTS IN LONG-TERM BONDS.

As of June 30, 1976, the Retirement System held $162.7 million cost value ($158.8 million market value) in common stocks. These securities generated $5.2 million in dividend income for a yield of 3.2%. On a percentage basis, 23.7% of the System's total portfolio or investment cost was in common stocks.

Appendix C compares the return on investment for bonds and stocks held by the Retirement System since stock purchases began in 1968-69. With the exception of fiscal year 1971-72, the bond portfolio return has exceeded that of the stock portfolio. During the time period 1969-70 through 1975-76, the average return on bond investment, including interest, dividends, and capital gains and losses, was 5.08% as compared to 2.65% for stocks.

A survey of 18 other California jurisdictions (See Appendix D) disclosed that the average portfolio percentage invested in common stoc is approximately 20.5%. Reduction of the System's investment in stocks to this average would provide $24.7 million for investment in bonds. Based on an average yield of 8.93% on new bond purchases made during 1975-76, reinvestment in bonds of the $24.7 million

in proceeds from sale of these common stocks would provide $800,000 in additional net revenue in the first year ($1.4 million in additional interest income minus a $600,000 capital loss) and an average of $1.4 million additional income annually thereafter. Appendix E lists this computation in detail.

In September 1976, the Retirement System proposed to the Retirement Board that their common stock holdings be reduced to a maximum of 20% of total assets. However, it was subsequently decided not to proceed with this proposal pending what the System believes would be a more favorable investment climate for such action.

CONCLUSION

The Retirement System could earn an additional $1.4 million annually in investment income by reducing its common stock holdings from 23.7% to 20% of portfolio cost and reinvesting the proceeds in bonds. This reduction in stock holdings would require the System to absorb a one-time capital loss of $600,000.

RECOMMENDATION

We recommend that the Employees Retirement System reduce its investment in common stocks from 23.7% to 20% of its total investments on a cost basis and reinvest the proceeds in long-term bonds.

SAVINGS

Implementation of this recommendation would have resulted in increased investment income of $1.4 million annually and a one-time capital loss of $600,000.

IN 1975-76 THE EMPLOYEES RETIREMENT SYSTEM MAINTAINED OVER $21 MILLION ON AN AVERAGE DAILY BASIS IN LOWER YIELDING SHORT-TERM COMMERCIAL PAPER, OVER $16 MILLION OF SUCH FUNDS COULD HAVE BEEN REINVESTED IN HIGHER YIELDING LONG-TERM BONDS. AS A RESULT, INTEREST INCOME OF APPROXIMATELY $450,000 ANNUALLY WAS LOST, AND ONE-TIME CAPITAL GAIN INCOME OF APPROXIMATELY $530,000 WOULD BE REALIZED AT MATURITY.

During the 1975-76 fiscal year, the Retirement System was invested in short-term[a] investments, averaging on a daily basis $21,060,656. These investments, which were exclusively in commercial paper[b], yielded $1,290,906; this amounted to a 6.13% return on investment.

The Retirement System investment staff indicated that the primary reason for maintaining some funds in short-term securities is to have funds available on a daily basis in sufficient quantity in order to take advantage of any unanticipated investment opportunities which may arise throughout the year. Such opportunities arise on an unpredictable basis, but we estimate the maximum unanticipated demand for cash for this purpose at $2,000,000 to $3,000,000 for a single occurrence.

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[a]Short-term investments for purposes of this report include commercial paper with a maturity of up to 2 years.

[b]Commercial paper is defined to mean unsecured corporate promissory notes issued to finance certain short-term credit needs in conjunction with bank loans. Corporations which typically issue commercial paper include utilities, industrial companies, finance companies, insurance companies, and bank holding companies.

In an effort to determine an adequate level for short-term investments, a survey of the investment practices of eighteen public retirement systems in California was conducted by our office. The results of this survey are provided in Appendix F. These results indicate that there is no direct relationship between total assets and the amount or percentage of total assets invested in short-term securities. Five systems with assets of $54 million to $210 million invested no funds in short-term securities. One system invested over $31 million or 7.9% of its assets in short-term securities. Another system with $1.8 billion in assets invested only $10 million or 0.56% of its assets in short-term securities.

The fact that our survey produced no consistent pattern for the investment practices of public retirement systems suggests that investment decisions for each system are based on individual assessments of the unique characteristics, needs, and past experiences of the individual systems. In terms of the San Francisco Employees Retirement System, we have estimated that the maximum requirement for cash that is likely to result from unanticipated investment opportunities would be $2 million to $3 million at any one time. However, for the sake of conservatism, we conclude that an average daily investment of $5 million in short-term securities should be adequate for these purposes.

If the Retirement System reduced its investments in short-term securities from a level of more than $21 million on an average daily basis to approximately $5 million on an average daily basis, more than $16 million would be released for other higher yielding investment purposes. If these funds were invested in long-term bonds for

which the yield on bonds purchased in 1975-76 was 8.93%, the net increase in investment income would be about $450,000 annually. Furthermore, a one-time capital gain of about $530,000 would be realized at the maturity of those bonds based on the average discounted price for bonds purchased by the Retirement System in 1975-76 at 96.8% of par.

CONCLUSION

The Retirement System during 1975-76 maintained an average daily investment in short-term securities of over $21 million which earned a 6.13% annual rate of return. Since an investment of $5 million on an average daily basis would have been sufficient for the purpose of meeting unanticipated investment opportunities, over $16 million could have been invested in long-term bonds at higher interest rates. Based on the discount price and yield rates for bonds purchased by the Retirement System in 1975-76, additional interest income of about $450,000 annually was lost and one-time capital gain income of approximately $530,000 would be realized at maturity.

RECOMMENDATION

We recommend that the Employees Retirement System reduce its lower yielding short-term investments from over $21 million on an average daily basis to an average daily amount of about $5 million and invest the difference of over $16 million in higher yielding long-term bonds.

SAVINGS

Implementation of this recommendation would have resulted in increased interest earnings of approximately $450,000 annually and one-time capital gain income of about $530,000.

THE EMPLOYEES RETIREMENT SYSTEM HAS MAINTAINED EXCESSIVE CASH BALANCES OF ABOUT $7 MILLION DAILY WITH THE TREASURER'S OFFICE. AS A RESULT OF THE TREASURER'S RESTRICTED LOW YIELDING INVESTMENTS, EARNINGS OF APPROXIMATELY $196,000 WERE LOST IN 1975-76.

The Retirement System maintains cash deposits with the Treasurer's Office. These deposits result from employee and employer contributions, dividends and interest from investments, and the sale of securities. Reductions from these deposits occur when benefit payments are made to retired employees, when employees withdraw their contributions, and when securities are purchased. During 1975-76, the average daily cash balance amounted to $11,948,000.

At the same time that cash deposits are maintained with the Treasurer, the Controller keeps a record of warrants outstanding. Warrants outstanding refers to checks written by the Retirement System which remain uncashed. The average daily balance of warrants outstanding in 1975-76 was $4,126,000.

The difference between the average daily cash balance on deposit with the Treasurer of $11,948,000 and the Controller's average daily balance of warrants outstanding of $4,126,000 represents an excess daily cash balance of $7,822,000. Such monies are termed excess in the sense that the Controller only requires a cash balance be maintained which is adequate to cover warrants outstanding. It is also necessary, however, for the Retirement System to maintain cash to cover employee contribution withdrawals, investment expenses, and payrolls for employee benefits. We estimate that the daily cash requirements for these purposes would total approximately $800,000. Taking these requirements into account, we estimate that the Retirement System is maintaining a daily cash balance of approximately $7 million over needs.

While the Treasurer invests all cash balances, he is restricted in his investments. Therefore, during 1975-76, the average yield on investments made by the Treasurer amounted to only 6.12%. The Retirement System during 1975-76 earned an average return on bond investments of 8.93% or 2.81% in excess of the Treasurer.

If the Retirement System had monitored its daily cash balance so as to provide for outstanding warrants, employee contribution withdrawals, investment expenses, and payrolls for employee benefits, approximately $7,000,000 of excess cash could have been invested in long-term bonds. It is estimated that in 1975-76 the investment of this amount in long-term bonds by the Retirement System would have resulted in net additional investment earnings of about $196,000.*

*This sum represents the difference between what the Treasurer's rate of return would produce and what the Retirement System's 1975-76 long-term rate of return would produce. Actually, the Retirement System would realize additional investment income of over $625,000 annually, resulting in reduced employer contributions, but approximately $429,000 of this total would be a reduction in general fund interest revenue. Therefore, a net increase of $196,000 results. The net increased revenues would result in a net reduction of ad valorem taxes required by the City and County.

CONCLUSION

The Retirement System during 1975-76 maintained excess daily cash balances with the Treasurer of $7,804,000 of which about $7,000,000 was available for long term bond investment at a rate of return 2.81% greater than that earned by the Treasurer.

RECOMMENDATION

We recommend that the Employees Retirement System discontinue maintaining excessive cash balances with the Treasurer and invest such excess cash in long-term bonds.

SAVINGS

Implementation of this recommendation would have resulted in increased investment earnings of approximately $196,000 annually.

THE METHODS USED BY THE EMPLOYEES RETIREMENT SYSTEM FOR ESTIMATING THE CITY AND COUNTY'S (EMPLOYER) CONTRIBUTIONS TO THE RETIREMENT FUND ARE INADEQUATE. IMPROVED ESTIMATING TECHNIQUES WOULD RESULT IN A ONE-TIME INCREASE OF INVESTMENT REVENUE OF OVER $570,000.

Currently there is a 14-month delay between the time that the City and County payroll is issued and the time that the actual employer contributions from that payroll are computed and the full amount of cash due becomes available to the retirement fund. The Retirement System reported that this delay is caused by the City and County's EDP Division. During this 14-month interval, the Investment Division of the Retirement System is allowed to invest funds based on an estimate of the employer contributions. Personnel in the Accounting Division of the Retirement System stated that this estimate is based on 90% of an average monthly payroll for the preceeding year as adjusted for wage increases.

The funds which represent the difference between the estimate of employer contributions and the actual employer contributions are invested by the Treasurer. However, the Treasurer is restricted in his investments which, in 1975-76, averaged a rate of return of 6.12% whereas the Retirement System during 1975-76, earned a return on its long-term bond investments of 8.93%. Therefore, the difference in the rate of return between long-term investments made by the Retirement System and short-term investments made by the Treasurer was 2.81%.

Based on selected actual 1976-77 biweekly payrolls, the average amount of employer contributions was $3.3 million. However, the Retirement System's 1976-77 monthly estimate of employer contributions is $5.7 million which is the equivalent of only

$2.6 million biweekly. As a result of this significant difference, and the 14-month period before it will be recovered, it is estimated that the retirement fund is currently losing the use of $20.3 million.

There are two principal contributing factors to the low estimates of employer contributions:

The first factor is that estimates are made on a monthly basi whereas City and County payrolls are paid on a biweekly basis. Biweekly payrolls mean that two months in an given year have three pay periods while the remaining 10 months have two pay periods. Current monthly estimates of employer contributions made by the Retirement System are based on a month having two pay periods. Consequently, two entire payrolls with employer contributions totalling about $3.3 million each are not included in the estimate of employer contributions to the retirement fund.

The second factor is that the estimates of employer contributions to the retirement fund based on 90% of prior year payrolls as adjusted for wage increases are much lower than 90% of actual employer contributions. Our sample of 1976-77 payrolls indicates that estimates of employer contributions made by the Retirement System are less than 80% of actual employer contributions. This comparison of estimated and actual payments suggests that the present method of estimating employer contributions is not adequate.

Given the current lag between estimates of employer contributions and the time that the actual employer contributions to the Retirement System are known, the Retirement System is able to invest the monthly estimate of employer contributions plus the difference between the estimated and the actual contributions for payrolls occuring fourteen months previously. If the estimates were improved, there would be a period of approximately one year during which the Retirement System would receive the revised estimated employer contributions plus the difference between the estimated employer contribution and the actual employer contributions in the previous year. After approximately one year, however, the difference between the estimated and the actual employer contributions should decrease significantly due to the improved estimates. Thus the additional revenue received by the Retirement System as a result of these changes should be treated as a one-time event rather than an increase that will be available for each successive year.

If estimates of employer contributions were improved, one result would be a quicker transfer of funds from the Treasurer to the Retirement System. This transfer would produce an increased return on the investment of these funds, but the increased return would benefit the Retirement System rather than the general fund of the City and County. However, the increased return would result in reduced employer contributions since additional assets would be made available to the Retirement System for investment. Therefore, the net increased revenues from the higher return would result in a net reduction of ad valorem taxes required by the City and County.

CONCLUSION

The Employees Retirement System could increase its one-time net income by over $570,000 by revising the method it uses to estimate employer contributions to the retirement fund. This additional revenue would be available during the course of approximately one year and could produce a reduction in the employer contribution rate paid by the City and County during that period of time.

RECOMMENDATIONS

We recommend that the Employees Retirement System:

- Base the estimate of employer contributions on 26 biweekly pay periods rather than on 12 monthly pay periods as is the current practice.

- Base the estimate of employer contributions on the prior payroll rather than on the prior year payroll as is the current practice. This estimate should be derived by the Accounting Department adding the total wages and salaries paid from both the permanent and temporary payrolls for those positions which are subject to retirement. This estimate should be completed within approximately 5 days after the payrolls are released and the transfer of funds to the Retirement System should follow immediately.

SAVINGS

Implementation of these recommendations will result in a one-time net increase in investment earnings of approximately $570,000.

Section Deleted

THE WORKLOAD OF THE RETIREMENT BOARD IS EXCESSIVE, PARTICULARLY IN THE AREA OF DISABILITY HEARINGS. WHILE THE BOARD HEARD AND DECIDED 298 CASES FROM 1/1/76-6/30/76, IT IS ESTIMATED IT WILL TAKE THE BOARD AT LEAST SIX MONTHS TO ELIMINATE ITS BACKLOG OF CASES WITHOUT CONSIDERING THE TIME REQUIRED FOR NEW CASES.

During the six months from January 1 through June 30, 1976, the Retirement Board heard and decided 298 cases which included determinations regarding applications for disability retirements, Workers Compensation and subrogation settlements as well as various other decisions about adjustments in retirement rates, stipulations and similar requests. In January 1977, there was a backlog of 300 of such cases.

This workload of individual cases is only a part of the responsibility of the Board. It also regularly considers investment and other major policy questions, overall administration of the System, and approval of a budget and of various expenditures and contracts as well as lists of regular retirements.

The members of the Retirement Board are not compensated. They, of necessity, can devote only part of their time to Board duties and the time required for the preparation they must make for meetings is extensive. The advance reading of case documents and preparation for policy decisions imposes a heavy duty. The Board held 46 weekly meetings in fiscal year 1975-76. Meetings held more frequently than once a week appear to be not feasible in view of the members' part-time responsibility and the legal and technical nature of the decisions they must make. It is calculated that the existing backlog of disability cases will take at least six months and possibly as long as eight months for the Board to process without considering the time required for new cases.

The State's Workers Compensation Appeals Board (WCAB) handles its workload by delegating responsibility over disability claims to a hearing officer, namely a Referee. The Referee serves full time. He must be a member of the State Bar with substantial prior experience in industrial disability law or trial work. The salary scale paid by the WCAB for this position ranges from $28,452 to $34,392 per year.

CONCLUSION

The workload imposed on the Retirement Board, particularly in the area of of deciding individual disability cases, has grown beyond what can be expected of volunteer, part-time members meeting once each week. Furthermore, disability decisions involve technical medical and legal issues which can be more effectively resolved by a full time specialist prepared by training and experience to make such decisions.

RECOMMENDATION

On November 12, 1976, the President of the Board of Supervisors requested the City Attorney to draft a charter amendment to provide for a hearing officer for disability cases. Our finding is consistent with the President's request. We recommend that the Board of Supervisors submit a charter amendment to the electorate to provide that the determination of eligibility for disability benefit applications be delegated to a professional hearing officer.

COST/BENEFIT

- The additional cost of hiring a hearing officer and related secretarial assistance is estimated at $52,800 for salary and fringe benefits.
- The employees of the City would benefit by their obtaining decisions about their disability applications on a current basis.
- The Retirement System would benefit because its Board could devote its time and energy totally to other major policy matters.

ACCOUNTING AND BUDGETING OF DISABILITY PAYMENTS IS NOT UNIFORM FOR VARIOUS CATEGORIES OF CITY AND COUNTY EMPLOYEES. AS A RESULT, THERE HAS BEEN INADEQUATE DISCLOSURE OF MOST OF THESE PAYMENTS WHICH AMOUNTED TO $5.1 MILLION, INCLUDING OVER $4 MILLION FOR POLICE AND FIRE DEPARTMENT UNIFORMED PERSONNEL, IN 1975-76.

City employees are paid widely different amounts of compensation during periods when they are temporarily disabled by on-the-job injuries. Police, Fire and Sheriff's uniformed personnel receive full pay, an average of about $375 per week for Police and Fire and approximately $275 for Sheriff's officers from regular salary appropriations, without disclosure that the salary funds include disability payments. All other City employees are paid up to the maximum Workers Compensation amount, presently $154 per week, as determined by the State.

The table below shows the total disability benefits for injuries on duty paid to separate groups of employees during the 1975-76 fiscal year. The amounts paid are from both Workers Compensation and Salary appropriations. This data is only available in detailed payroll records.

Department	Employee Classes	Total Budgeted Positions	Percent	Total Compensation Paid	Percent
Fire	Uniformed	1,780	8	$ 2,292,000	45
Police	Uniformed	1,938	9	1,790,000	35
Sheriff	Uniformed	308	1	77,000	1.5
Municipal Railway	Platform, Craft	2,260	11	358,000*	7
All other	Miscellaneous	15,069	71	590,000	11.5
Total City & County		21,355	100	$ 5,107,000	100.0

*During 1975-76, these Municipal Railway employees were paid full wages from Workers Compensation and salary appropriations. They now are paid Workers Compensation, as are miscellaneous employees, at the rate of $154 per week.

As can be seen from this table, uniformed personnel, especially from the Police and Fire Departments receive a relatively large proportion of the total disability benefits paid to employees of the City and County.

It is recognized that safety personnel are exposed more than other City and County employees to the hazard of injury in the performance of their duties. On the average day during 1975-76, 103 police officers and 134 firemen (6% and 7% respectively of the authorized uniformed forces of the Police and Fire Departments) were not working due to temporary disabilities. However, the costs to the City and County of temporary disabilities among uniformed public safety personnel and Municipal Railway employees have not been carefully reviewed in the budget process. Furthermore, expenditure data are not readily available to facilitate departmental and overall management of this part of personnel administration. Therefore a review of the budgets for those departments does not reveal the true cost of on-the-job disabilities to public employees.

The lack of budgetary and accounting methods of other City departments results in inadequate disclosure of the costs of on-the-job injuries to public employees and impairs the effective control of such costs. We recognize that budget presentation is not the responsibility of the Retirement System. Currently, the budgets of the various City and County departments do not uniformly reflect the cost of disability payments to public employees. This lack of uniformity means that it is difficult to establish, through the use of departmental budgets, an accurate cost of public employee disabilities both within individual departments

and on a City and County-wide basis. To the extent that information on costs is necessary to control those costs, that control is curtailed by the current budgetary treatment of disability payments. It should be noted the Retirement System reported that it has repeatedly requested that City and County departments fully disclose all disability costs.

CONCLUSION

The current budgetary treatment of disability payments for public employees makes it difficult to assess the true and accurate cost of public employee disabilities. This problem is particularly evident with respect to disability payments to uniformed public safety and MUNI personnel. However budget presentation is not the responsibility of the Employees Retirement System.

RECOMMENDATION

We recommend that the Employees Retirement System request the Controller to devise a system to ensure that all City and County departments fully disclose the costs of disability payments in budgets and expenditure reports in a uniform and consistent form.

BENEFIT

Implementation of this recommendation will provide full disclosure of a substantial cost to the City heretofore hidden. This will permit a focus of attention on the cost and will ultimately result in greater control of the expense for temporary disabilities of all City employees.

INCONSISTENTLY APPLIED MEDICAL STANDARDS USED IN THE HIRING AND PROMOTING OF POLICE AND FIRE DEPARTMENT UNIFORMED PERSONNEL COULD RESULT IN DISABILITY RETIREMENTS FOR SUCH EMPLOYEES BEING UNNECESSARILY HIGH. IN 1975-76, SAN FRANCISCO HAD 112 DISABILITY RETIREMENTS AS COMPARED TO 67 FOR THE CITY OF LOS ANGELES EVEN THOUGH LOS ANGELES HAD NEARLY 3 TIMES THE BUDGETED POSITIONS OF SAN FRANCISCO.

From 1971-72 to 1975-76, 323 disability retirements were granted to uniformed employees of the San Francisco Police and Fire Departments. The rate of such retirements was more than three times the rate of disability retirements in Los Angeles over the same period of time. For 1975-76 the rate of such disability retirements to budgeted positions in San Francisco was five times the rate of such retirements in Los Angeles.

	Number of Uniformed Positions Budgeted	Number of Industrial Disability Retirements Granted	Retirements as Percents of Positions
San Francisco			
1971-72	3,693	47	1.3%
1972-73	3,687	52	1.4%
1973-74	3,733	69	1.8%
1974-75	3,739	43	1.2%
1975-76	3,718	112	3.0%
Totals	18,570	323	1.7%
Los Angeles City			
1971-72	10,696	36	0.3%
1972-73	10,607	63	0.6%
1973-74	10,734	41	0.4%
1974-75	10,850	66	0.6%
1975-76	10,722	67	0.6%
Totals	53,609	273	0.5%

While there was a strike in 1975-76, which could have prompted increased applications for disability retirements, the existence of the disability must still have been factually determined.

There are a number of factors which contribute to a high rate of disability retirements. Among these factors are problems of morale and inadequate record systems. In the case of San Francisco disability retirements, however, there is evidence that inconsistently applied medical standards can be a partial cause of the high rate of such retirements. A transcript of a joint meeting of the Retirement Board, Civil Service Commission, and Police and Fire Commissions on July 7, 1976, provides some of this evidence. That transcript cites two cases where employees of the Police Department were granted disability retirements for injuries which had pre-dated their hiring but which had not been detected at the time of employment. Additional evidence was found where an employee of the Fire Department was promoted even though the employee's hearing ability did not meet the standards for promotion.

A further example that the medical standards used for hiring and promoting Police and Fire Department employees are inconsistently applied is that x-ray examinations are given by the Civil Service Commission to men but not to women, that the Workers Compensation Division records of the Employees Retirement System are not routinely provided to police and fire surgeons as background material for promotional examinations and that promotional examinations conducted by the Police and Fire Departments do not include x-rays or electrocardiographic studies. Such studies are required for newly hired personnel. These inconsistencies can contribute to the relatively high rate of disability retirements granted to police and fire employees. It should be noted that the Retirement System has previously requested the Civil Service Commission to review and revise the medical standards for appointment and promotion of uniformed personnel, and is again in the process of doing so.

We recognize that most of the problems fall outside of the responsibility of the Retirement System and involve the Civil Service, Police and Fire Departments.

CONCLUSION

Inconsistencies in medical examination standards can be a significant factor contributing to the relatively high rate of disability retirements which are granted to uniformed employees of the San Francisco Police and Fire Departments. Most of these problems relating to those inconsistencies fall outside of the responsibility of the Retirement System and involve the Civil Service, Police and Fire Departments.

RECOMMENDATIONS

We recommend that the Employees Retirement System:

- Consult with the Civil Service Commission and the Police and Fire Departments for the purpose of reviewing and revising the medical standards for appointment and promotion of uniformed personnel with the objective of applying such standards on a consistent basis.

- Provide, on a routine basis, Workers Compensation records to Police and Fire Department surgeons prior to promotional examinations.

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IT IS PROJECTED THAT THE EMPLOYER CONTRIBUTIONS PAID BY THE CITY AND COUNTY FOR SOCIAL SECURITY, AMOUNTING TO $12.5 MILLION IN 1976-77, WILL HAVE INCREASED TO APPROXIMATELY $43 MILLION BY THE YEAR 2001. ALTHOUGH INITIALLY FOR THE FIRST SEVEN YEARS COSTS WOULD INCREASE BY AN AVERAGE OF $1.4 MILLION ANNUALLY, THE CITY AND COUNTY COULD SAVE APPROXIMATELY $148 MILLION OVER A 21-YEAR PERIOD BY WITHDRAWING FROM THE FEDERAL SOCIAL SECURITY SYSTEM AND ESTABLISHING A SUPPLEMENTAL RETIREMENT SYSTEM FOR EXISTING EMPLOYEES.

Entrance Into Social Security

Coverage for City and County employees under the Federal Social Security System became available on July 1, 1960. This coverage was added to the benefits provided by the San Francisco Employees Retirement System by the voters through Proposition "N", approved in November 1959, and was funded through matching contributions from the employees and the City and County. At that time, integration of the Social Security program and the Employees Retirement System program was the least costly method of increasing the retirement, disability and survivorship benefits for employees of the City and County. As a result of the integration of these two programs, employees of the City and County gained the following increased or additional benefits: (1) basic retirement benefits beginning at age 62; (2) survivorship benefits payable to the surviving spouse and/or dependent children; (3) disability benefits regardless of whether the disability is job-related; (4) medicare benefits; and (5) retirement benefits from the Employees Retirement System.

Costs to the City

In the City's first year of participation in the Federal Social Security program, (1960 - 1961) $1.36 million was budgeted by the City and County to cover the cost of employer social security contributions. This sum represented 0.6% of the total budget for the City and County for that year. For fiscal year 1976-77, the budget for employer contributions to social security by the City and County had grown to $12.5 million which represented 1.6% of the total budget for that year. Based on past experience and projections of future social security taxes, we have estimated that by the year 1980, the City and County employer contributions to social security will reach $15.2 million and by the year 2001, the employer contributions paid by the City and County into social security will reach $[illegible]3 million annually or an increase of 3,062 percent from 1960-61. (See Appendix G).

The City and County has no control over the costs of the social security program. The Federal Government establishes the benefits which social security provides as well as the tax rates which the employers and employees are required to pay to support the program. Recent increases in the cost of the Social Security program to the City and County have resulted primarily from increases in the social security tax rate and increases in the income level on which that tax is paid rather than from increases in the number of City and County employees. Because of well-publicized deficiencies in the social security trust fund, it is likely that both the social security tax rate and the income level on which that tax is paid will continue to increase. (See Appendix G) The seriousness of the

social security funding problem cannot be overemphasized. In 1960 the social security trust fund amounted to $20.3 billion. This amount was the equivalent of approximately 23 months benefit payments. By 1975, the trust fund had increased to only $37 billion which was the equivalent of about 7 months benefit payments. By 1981 the trust fund is estimated to contain $17.9 billion or the equivalent of less than two months benefit payments. In summary the Social Security System, under its present funding plan, is expending substantially more in benefits than it it taking in, in revenue.

The Option to Withdraw

The City and County of San Francisco has an option to withdraw from the social security program. The Social Security Act contains a provision whereby public jurisdictions which have been covered under the social security program for seven or more years may elect to withdraw from the program. A formal notice is required and there is a two-year waiting period before withdrawal becomes effective. The Board of Supervisors may unilaterally, by resolution, declare that the City and County become separated from the social security program and direct the Controller to file the notice of intent to separate. During the two-year waiting period, the Board of Supervisors could direct the Controller to rescind any notice of intent to separate from the social security program. Thus, filing the notice of intent to separate from the Social Security System is not an irrevocable action.

Many small and medium sized public jurisdictions throughout California and the nation have filed notices of intent to withdraw from the Social Security program in recent years. A number of these jurisdictions reconsidered during the two-year waiting period, others did not. To date, public jurisdictions in the United States with a total of about 49,000 employees have withdrawn from the Social Security System. Of these jurisdictions, San Jose (2,200 public employees) is the largest. Other large jurisdictions chose not to enter the Social Security System. Included in this category are the cities of Los Angeles and Chicago.

If the City and County of San Francisco were to withdraw from the Social Security system, decisions would have to be made regarding the provision of benefits to those employees who had paid social security taxes but who had not yet retired or otherwise become eligible for social security benefits. Eligibility for social security benefits is based on a combination of age and years of participation in the social security program. Benefit levels under social security are weighted to reflect total wages during the period of coverage so that covered employees with higher wages and more years of coverage will receive higher benefits at retirement.

There is no case law precedent to indicate if the City would have a legal obligation to provide benefits to employees equivalent to what they would have received under the social security program. However, since withdrawal from social security coverage would reduce retirement and disability benefits for some existing employees and

eliminate the possibility of those benefits for other existing employees, withdrawal from the System might prompt the City and County to provide some sort of supplemental coverage to existing employees.

Separation from Social Security Without Providing Supplemental Retirement System Benefits

Under this option employees who had not achieved eligibility for social security benefits at the time of separation would not become eligible for those benefits as long as they remained employed with the City and County. Employees who had acquired eligibility by years of coverage but who were not yet of retirement age would receive a reduced level of social security benefits upon retirement. Disability and medical benefits for all employees would be reduced to what is provided by City, County, and state coverage. The Employee Retirement System benefits would remain in force. Social security taxes would no longer be required from the employer and the employees. The immediate effect of no longer paying these taxes would be a wage increase of 5.85% for all employees on wages up to $16,500 or a maximum of $965.25 in 1977 and a saving to the City and County of the employer social security contributions ($12.5 million in 1976-77).

Separation from Social Security with Providing Supplemental Retirement System Benefits

Provision of supplemental benefits would be limited to those existing employees who had previously been covered by social security and who would forego benefits or potential benefits in the event of a separation of the City and County from the social security program.

The premise for providing supplemental benefits to this group of employees would be that these employees had established an expectation that they would receive a certain level of retirement benefits through a combination of benefits paid by Social Security and the Employees Retirement System.

We have investigated the possibility of establishing a Supplemental Retirement System covering only those existing employees who would forego social security benefits in the event that the City and County separate from the Social Security System. Such a plan would be of limited duration, lasting only as long as is necessary to provide benefits to existing employees of the City and County at the time of separation from the social security program. All employees hired after that time would be eligible only for those benefits provided by the Employees Retirement System. We have calculated that a Supplemental Retirement System plan could provide the same level of retirement benefits which would have otherwise been provided from a combination of Social Security and the Employees Retirement System. The cost to employees would be no more than would have been required by the combination of social security taxes and employee retirement contributions. For the first seven years, the cost to the City and County would average approximately $1.4 million per year higher than under the current combination of social security employer taxes and employer contributions to the Employees Retirement System. After that time, however, the costs to the City and County would drop dramatically so that over a twenty-one year period a net savings of approximately $148 million would result. (See Appendix H)

CONCLUSION

The City and County could save approximately $185 million over a twenty-one year period by dropping out of the Social Security System and providing for supplemental retirement benefits of a comparable value to existing employees in lieu of social security benefits. The City would have complete control over the cost and funding of a Supplemental Retirement System. Benefits for future City and County employees would be limited to what is provided by the Employee's Retirement System. This would result in a lower level of benefits for those employees from the levels which are now available.

RECOMMENDATION

We recommend that the Board of Supervisors retain an actuarial firm and professionals in the benefits field to study the net potential savings which would result from the withdrawal of the City and County from the Social Security System and the implementation of a Supplemental Retirement System for existing employees.

If the results of such a study validate our projected savings, it is recommended that the City and County take the necessary steps to withdraw from the Social Security System. The actuarial firm should consider any congressional action regarding the matter of Social Security for public jurisdictions.

SAVINGS

Implementation of this recommendation could result in reduced expenditures for Social Security costs of approximately $148 million over a 21-year period.

CITY AND COUNTY OF SAN FRANCISCO
RETIREMENT BOARD OFFICE OF THE GENERAL MANAGER
EMPLOYEES' RETIREMENT SYSTEM
770 GOLDEN GATE AVENUE
SAN FRANCISCO, CA. 94102

February 15, 1977

Harvey Rose, Budget Analyst
Bureau of the Budget
Board of Supervisors
Room 235, City Hall
San Francisco, California 94102

Dear Mr. Rose:

In response to your Management Audit Report delivered to this office on February 9, 1977, the following is submitted.

In July 1976, we were advised by your office that a management audit of the Retirement System would be undertaken. We welcomed the conduct of such an audit, particularly in view of the fact that this office has been beset with problems related to excessive personnel turnover; reduction in personnel; legislative changes, including the establishment of a new retirement system for Police, Fire and Miscellaneous employees; salary litigation; delays in producing retirement warrants; approximate 14 month lag in payroll account maintenance, one of the effects of which is the delay in the availability of current data necessary to the conduct and completion by the consulting actuaries of the valuations and investigations of the Retirement System upon which contribution rates of the City and employee are established as well as the determination of the actuarial assumed rate of interest earnings of the fund; excessive delays in production of audit reports; lack of automated capability of Worker's Compensation records; unprecedented increase in applications for retirement, etc.

Therefore, as has always been the policy of this office in the past, the staff of the Retirement System was instructed to cooperate with your office and staff by making all the records and procedures of the Retirement System available and to spend as much time as you deemed necessary to assist your staff in the completion of your management audit.

At your request, response with regard to the investment findings of your report was submitted under separate cover earlier today which is incorporated herein by reference.

With regard to the remainder of your report, answers to your findings are recommendations are as follows:

CITY AND COUNTY OF SAN FRANCISCO
EMPLOYEES' RETIREMENT SYSTEM
INVESTMENT DIVISION
770 Golden Gate Avenue
San Francisco, California 94102

February 15, 1977

Mr. Harvey Rose
Budget Analyst
Bureau of the Budget
Board of Supervisors
City and County of San Francisco
City Hall
San Francisco, California 94102

Dear Mr. Rose:

In accordance with your request at the audit exit conference with the Retirement System's staff on February 9, 1977, we are submitting herewith 5 copies of our response to your report. Also enclosed are 5 copies of Crocker Investment Management Corporation's response to your report.

Sincerely,

George B. Springman
Chief Investment Officer

GBS/z
Encs.

February 15, 1977

FORMAL RESPONSE TO THE BUDGET ANALYST'S REPORT ON INVESTMENT FINDINGS SUBMITTED TO THE RETIREMENT SYSTEM STAFF ON FEBRUARY 9, 1977

INTRODUCTION

This is a formal response to the Budget Analyst's report submitted to the Retirement System staff on February 9, 1977. This response addresses the Budget Analyst's findings pertaining to the investments of the Retirement System.

We commend the Budget Analyst's quest to seek means of enhancing the yield on the Retirement System's portfolio. Unfortunately, the rationale of the Budget Analyst's findings is predicated upon a narrow view based solely on increasing current income and fails to recognize the concept of total return which encompasses not only current income but, also importantly, includes appreciation and depreciation of securities. The Budget Analyst's report totally ignores major investment considerations such as quality and call protection which are essential for sound and prudent investment management.

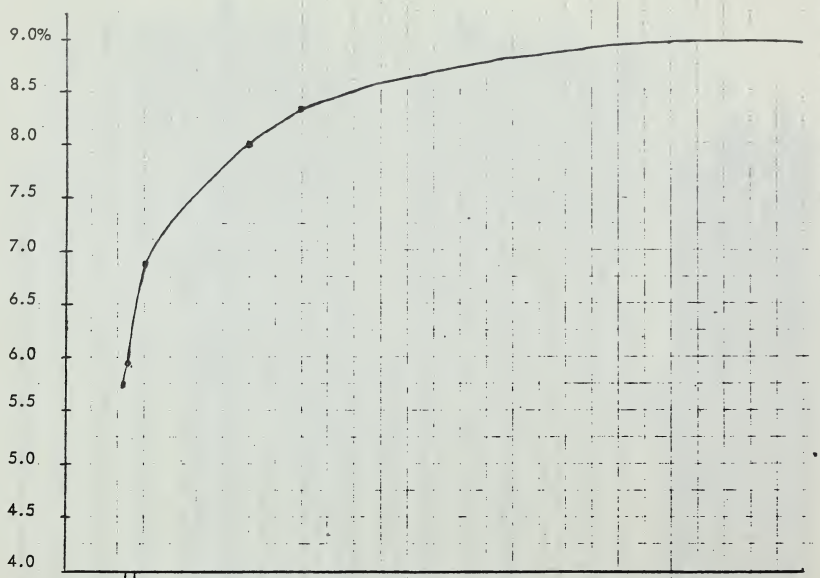
Within the body of this response, it will be demonstrated that the finding to sell $156,000,000 of low interest bonds and, through reinvestment, increase the income annually by $2,300,000 is incorrect and illustrates a lack of understanding money market instruments. In addition, this response will address the other findings of the Budget Analyst's report.

The Budget Analyst's report states the following finding:

> THE EMPLOYEES RETIREMENT SYSTEM HAS MAINTAINED $156.4 MILLION OF PRIOR YEARS' LOWER YIELDING BOND INVESTMENTS WITH YIELDS AS LOW AS 2-3/4%. AS A RESULT OF DECLINING TO SELL SUCH BONDS AT A LOSS AND REINVESTING THE PROCEEDS IN HIGHER YIELDING BONDS AVERAGING AN 8.93% RETURN IN 1975-76, ANNUAL INVESTMENT INCOME OF APPROXIMATELY $2.3 MILLION WAS LOST.

In the context of the Budget Analyst's report, it further states: "If these bonds had been sold at their market value and the proceeds of those sales reinvested at the average rate of return for bonds purchased by the Retirement System during 1975-76 (8.93%), an additional $2.3 million in investment income could have been realized. If such investments had been made in bonds with equivalent maturity to those being sold, the total additional investment realized by the year 2014 would be $42.9 million, assuming a reinvestment of earnings at 7%."

Based on June 30, 1976 market values, the above statement is unachievable simply because you cannot obtain the long-term rate on the purchase of bonds with short and intermediate term maturities. In other words, at any point in time, interest rates on short, intermediate, and long-term bonds differ materially depending on market conditions. To illustrate this point, refer to the yield curve on page 3, Figure 1, which outlines the various interest rate levels as of June 30, 1976. One can readily see that the interest rates obtainable on short and intermediate bonds are lower than the interest rate level for long term bonds. Clearly one can see that you cannot sell a short or intermediate term bond and invest in an equivalent maturity at the long term rate.



YIELD CURVE AS OF JUNE 30, 1976 *

* Source: Salomon Bros.

Figure 1

Page 5, Schedule 1, outlines how erroneous and overstated the Budget Analyst's findings are with regard to the proposed sale of bonds. This schedule takes actual examples from the Budget Analyst's report and compares them with yields obtainable on the respective maturities outlined in the yield curve chart (page 3, Figure 1). Details of the computations are contained in Appendices A through E. Please bear in mind that the above referenced computations do not include commission costs.

While the investment staff does not concur with the scope and magnitude of the Budget Analyst's finding, we are cognizant that the amount of active bond management could be increased if the framework of the accounting and actuarial restraints were modified. We have attempted (see Appendix F) to adopt an accounting method whereby bond losses could be amortized over a period of time, thereby affording the Retirement System the opportunity of doing more bond swaps. The accounting method is somewhat avant-garde. To date, several governmental agencies have employed this methodology but, thus far, our outside auditors have not agreed to such procedures. We are continuing to pursue the issue and are hopeful we will be able to effect this change in the future.

EXAMPLES OF BOND TRADES RECOMMENDED BY BUDGET ANALYST'S REPORT SUBMITTED TO RETIREMENT SYSTEM STAFF FEBRUARY 9, 1977

Par Value	Description	Amount Purported to be Gained in Budget Analyst's Report	Amount to be Gained As Outlined in Response Appendices (A-F)	Amount Overstated by Budget Analyst's Report
$161,000	Denver Rio Grand 4-1/8% Due 10/1/76	$ 3,237	$ 42	$ 3,195
49,222	Kansas City Southern 4.45% Due 1/1/77	524	(218)	742
359,000	Louisville Nashville 3-3/8% Due 6/1/77	9,653	1,383	8,270
100,000	New York Telephone 3% Due 7/1/81	6,181	1,412	4,769
309,000	Ches. & Ohio 9-1/8% Due 6/1/83	27,846	9,610	18,236

Schedule I

The Budget Analyst's report further states:

> THE EMPLOYEES RETIREMENT SYSTEM HAD 23.7% OF ITS TOTAL INVESTMENTS IN COMMON STOCK AS OF 6/30/76 OR OVER 3% IN EXCESS OF THE 20.5% AVERAGE OF 18 OTHER CALIFORNIA AGENCIES. BASED ON THE AVERAGE YIELD OF 8.93% IN 1975-76 ON ITS LONG-TERM BOND PURCHASES VERSUS THE SYSTEM'S YIELD ON COMMON STOCK OF ONLY 3.2%, THE YIELD ON BONDS SIGNIFICANTLY EXCEEDED THE YIELD ON STOCKS. BY NOT HAVING LIMITED ITS STOCK INVESTMENTS TO ABOUT 20% OF ITS TOTAL INVESTMENT PORTFOLIO, AND CORRESPONDINGLY INCREASED ITS INVESTMENTS IN LONG-TERM BONDS, THE RETIREMENT SYSTEM LOST ADDITIONAL INVESTMENT INCOME OF $1.4 MILLION IN 1975-76. WHILE A ONE-TIME CAPITAL LOSS OF $600,000 WOULD HAVE BEEN INCURRED, THE INCREASED INCOME OF $1.4 MILLION WOULD BE EARNED ANNUALLY IF THE RETIREMENT SYSTEM REDUCED ITS INVESTMENTS IN COMMON STOCK AND CORRESPONDINGLY INCREASED ITS INVESTMENTS IN LONG-TERM BONDS.

At the outset, it is essential to state that averages of any group of governmental agencies is not germane to what is the proper level of common stock investments for the Retirement System. Such a survey of government agencies could, however, be helpful to ascertain if the Retirement System is within the range of other governmental agencies. While the average of 18 California funds held 20.5% of assets in common stocks, the range was from 0% to 32.25%. The Retirement System's 23.7% is well within this range.

Parenthetically, it seems somewhat illogical and inconsistent for the Budget Analyst's report to recommend conforming to the 20.5% average for 18 governmental agencies and, later in the report, recommend a reduction in commercial paper from 2.88% to 0.6% which is below the 2.15% average in commercial paper for the same 18 governmental agencies. What seriously should be considered is the question of not only why the Retirement System had 23.7% invested in common stocks, but, more importantly, why the Retirement System invests in common stocks at all.

Common stocks should be viewed within a total return concept in that they provide an investment return not only from current dividend payments but also through potentially higher future dividends and price appreciation. While the dividend yield is the easiest component of the return to understand, it is important to remember that historically it is less than half the total return provided by equities. Price appreciation of common stocks comes from companies retaining part of their earnings and reinvesting this money in new facilities. This process permits the company to show increased earnings and pay larger dividends in the future. Ultimately, the price of the common stock rises to reflect these higher dividends and the greater asset value of the shares.

The Budget Analyst's report points out that the dividend yield on common stocks held in the Retirement System's portfolio was 3.2% versus an average yield on bonds purchased in 1975-76 of 8.93%. This comparison neglects to take into consideration the potential future price appreciation of the equity portfolio. The investment community has done numerous studies of the historical total return provided by common stocks when held on a long-term basis. These reports place the return received by equity owners over thirty year periods in the 9.0% to 9.5% range. While this may seem like an unusually long period to study, it must be remembered that the Employees' Retirement System is, by its very nature, a long-term investor.

The Budget Analyst's report states that the average yearly return on the stocks held by the Retirement System was 2.36% versus 4.86% for the bonds. Aside from the fact that the equity return was superficially calculated using year-end cost figures which understate the return instead of time weighted numbers which would show that in the first year common stocks were held for only two months, it is important to determine the

reasons for the return being below normal expectations and, most importantly, whether those rates can be anticipated in the future.

In retrospect, it is not unreasonable to see that bonds have provided a greater return than stocks over the past eight years. It is only necessary to remember that this period encompassed some of the most tumultuous events in the history of the country compressed in a relatively short time span. From 1968 through 1976, we have experienced two recessions, the last being the worst since the 1930's depression; double digit inflation; an oil embargo followed by the quadrupling of crude prices; the most unpopular war in the country's history; a President resigning in disgrace; and tremendous social unrest.

As common stock prices depend upon investor perceptions of the future, in hindsight it would have been remarkable had equities provided better returns than they did with investors being subjected to these events. However, it appears extremely unlikely that we will continue to witness a string of occurrences in the future which are as devastating as the ones in the recent past.

The Retirement System does not determine the proportion of funds to be invested in common stocks in a random manner nor do we base the decision on what the average California jurisdiction is doing. The mix of stocks and bonds to be held in the portfolio is under continuous review, subject to economic forecasts of Gross National Product, corporate profit levels, and interest and inflation rates. These forecasts are used to determine the expected rate of return and degree of risk for alternative investments for the Retirement System's funds.

It is interesting to note that in September, 1976, formal consideration was given to reducing the equity position of the portfolio to 20% and reinvesting the proceeds into fixed income securities. At that time, our valuation models, which compare the total expected return from stocks and bonds under varying economic conditions, indicated that there was a significantly higher probability of achieving a superior rate of return over the intermediate term in stocks than in bonds. Based on these findings, it was determined to retain the then current mix of equities and bonds in the portfolio.

Our present valuation studies continue to show a higher expected return from the equity segment of the portfolio. It must be remembered, however, that equity investments have more inherent risk than do bonds. In view of this greater expected return balanced against their higher risk, we continue to believe that the present position in equities should be maintained. This view is based on our current forecasts and, as mentioned previously, is subject to constant review,and changes in the economic climate or equity price levels could lead us to recommend either increases or decreases in the equity position in the future.

In the Budget Analyst's report it further stated:

> IN 1975-76 THE EMPLOYEES RETIREMENT SYSTEM MAINTAINED OVER $21 MILLION ON AN AVERAGE DAILY BASIS IN LOWER YIELDING SHORT-TERM COMMERCIAL PAPER. $16 MILLION OF SUCH FUNDS COULD HAVE BEEN REINVESTED IN HIGHER YIELDING LONG-TERM BONDS. AS A RESULT, INTEREST INCOME OF APPROXIMATELY $450,000 ANNUALLY AND ONE-TIME CAPITAL GAIN INCOME OF APPROXIMATELY $530,000 WAS LOST.

In the judgment of the Retirement System's investment staff it would be very imprudent to establish an investment policy whereby the Retirement System's portfolio never exceeds $5,000,000 in short-term securities.

In viewing the Budget Analyst's survey of 18 selected governmental agencies, the amount invested in short-term securities ranges from 0.% to 7.90%. Had a more thorough survey been conducted covering a period of time rather than one specific date, it would have been ascertained that, for many of the governmental agencies, the amount invested in short-term securities would have varied depending upon conditions at that time.

The Budget Analyst's report further states:

> THE EMPLOYEES RETIREMENT SYSTEM HAS MAINTAINED EXCESSIVE CASH BALANCES OF ABOUT $7 MILLION DAILY WITH THE TREASURER'S OFFICE. AS A RESULT OF THE TREASURER'S RESTRICTED LOW YIELDING INVESTMENTS, EARNINGS OF APPROXIMATELY $196,000 ANNUALLY WERE LOST IN 1975-76.

In reviewing the Budget Analyst's finding, it is essential to point out the following:

1) According to preliminary figures computed by the Retirement System's staff, the excess daily cash balance is $6,408,381 and not $7,804,000 as stated in the Budget Analyst's report.

2) It must be borne in mind that the office of the Controller requests that monies paid monthly to Retired Employees must be unencumbered on the 28th day of the preceding month (when the 28th falls on a Saturday or Sunday, then the preceding Friday), whereas the warrants are not drawn until the last day of the month. In essence, this means that these funds are not invested for a period of 3 or 4 days monthly. Currently, this figure is $6,200,000.

3) The Budget Analyst's report assumes these monies would be invested at the long-term bond rate, which is an invalid assumption, insofar as the monies could very well be invested in short-term securities, which approximates the return the Treasurer's office obtained on investing these funds. Section 6.311 of the Charter states:

> All interest on moneys deposited shall accrue to the benefit of the city and county, except that interest derived from the deposit of any bond, utility, pension, trust or other fund created for a specific purpose shall accrue to such fund.

We do, however, concur with the Budget Analyst's report that the amount is excessive and the staff is currently taking measures to maintain a more efficient balance.

CONCLUSION

In closing, we wish to point out that the Retirement System's portfolio has the continuing guidance of a permanent internal Investment Division. Currently, the staff comprises some 43 years of professional institutional investment management experience. Of the four professionals on the staff, there are two Chartered Financial Analysts and one Chartered Financial Analyst Candidate. In addition, Crocker Investment Management Corporation is retained as Investment Advisor to the System. Crocker Investment Management Corporation enjoys a national reputation as an outstanding investment management firm. Furthermore, Appendix G outlines a list of additional investment information and research which is utilized by the Investment Division on a continuing basis.

APPENDIX A

The Retirement System held $161,000 par amount of Denver & Rio Grande Railroad 4-1/8% due October 1, 1976.

The Budget Analyst's report recommends the sale of the above referenced bond at its market price of 99-5/8 which would produce proceeds of $160,396.25 and incur a loss of $603.75. The $160,396.25 is reinvested at a long-term yield of 8.93%. The Budget Analyst's report, which includes the income increase from the 4-1/8% bond held to the 8.93% yield to be $3,841 (this was computed as a holding of six months maturity, where in fact the actual maturity is but three months). After the $603.75 loss is deducted, the net result is $3,237.

The yield level obtainable for a three month bond, as shown on page 3, Figure 1, is 5.75%. This realistic income level would produce an increased value at maturity of $646 and, after deducting the loss of $603.75, the net improvement is $42.

The Budget Analyst's report therefore is overstated as follows:

Budget Analyst's	$3,237 @	8.93%
Realistic level	42 @	5.75%
	$3,195	overstatement by Budget Analyst's report

APPENDIX B

The Retirement System held $49,222 par amount of Kansas City Southern Railway 4.45% due January 1, 1977.

The Budget Analyst's report recommends the sale of the above referenced bond at its market price of 98-7/8 which would produce proceeds of $48,668.25 and incur a loss of $554. The $48,668.25 is reinvested at a long-term yield of 8.93%. The Budget Analyst's report indicates the income increase from the 4.45% held bond to the 8.93% yield to be $1,078. After the $554 loss is deducted, the net result is $524.

The yield level obtainable for a six month bond, as shown on page 3, Figure 1, is 5.88%. This realistic income level would produce an increased value at maturity of $336 and, after deducting the $554 loss, a net disadvantage of $(218).

The Budget Analyst's report, therefore is overstated as follows:

Budget Analyst's	$524 @ 8.93%	
Realistic level	(218) @ 5.88%	
	$742	overstatement by Budget Analyst's report

APPENDIX C

The Retirement System holds $359,000 par amount of Louisville & Nashville Railroad 3-7/8% due June 1, 1977.

The Budget Analyst's report recommends the sale of the above referenced bond at its market price of 97-3/4, which would produce proceeds of $350,922.50 and incur a loss of $8,077.50. The $350,922.50 is reinvested at a long-term yield of 8.93%. The Budget Analyst's report, which includes the compounded income increase from the 3-7/8% held bond to the 8.93% yield, indicates this to be $17,730. After the $8,077 loss is deducted, the net result is $9,653.

The yield level obtainable for a one year bond, as shown on page 3, Figure 1, is 6.85%. This realistic income level would produce a compounded increased value at maturity of $9,460 and, after deducting the $8,077 loss, the net improvement is $1,383.

The Budget Analyst's report, therefore, is overstated as follows:

Budget Analyst's	$9,653 @ 8.93%	
Realistic level	1,383 @ 6.85%	
	$8,270	overstatement by Budget Analyst's report

APPENDIX D

The Retirement System holds $100,000 par amount of New York Telephone Co. 3% due July 1, 1981.

The Budget Analyst's report recommends the sale of the above referenced bond at its market price of 81, which would produce proceeds of $81,000 and incur a loss of $19,000. The $81,000 is reinvested at a long-term yield of 8.93%. The Budget Analyst's report, which includes the compounded income increase from the 3% bond held to the 8.93% yield, indicates this to be $25,181 and, after the $19,000 loss is deducted, the net result is $6,181.

The yield level obtainable for a 5 year bond, as shown on page 3, Figure 1, is 8.00%. This realistic income level would produce a compounded value at maturity of $20,412 and, after deducting the $19,000 loss, the net improvement is $1,412.

The Budget Analyst's report, therefore, is overstated as follows:

Budget Analyst's	$6,181 @	8.93%
Realistic level	1,412 @	8.00%
	$4,769	overstatement by Budget Analyst's report

APPENDIX E

The Retirement System holds $309,000 par amount of Cheasapeake & Ohio Railroad 9-1/8% due June 1, 1983.

The Budget Analyst's report recommends the sale of the above referenced bond at its market price of 106, which would produce proceeds of $327,540 and establish a profit of $18,540. The $327,540 is reinvested at a long-term yield of 8.93%. The Budget Analyst's report, which includes the compounded income increase (due to the profit generated additional proceeds available for reinvestment) from the 9-1/8% held bond to the 8.93% yield, indicates this to be $9,306. After the $18,540 profit is added, the net result is $27,846.

The yield level obtainable for a seven year bond, as shown on page 3, Figure 1, is 8.30%. This realistic income level would produce a compounded decreased value at maturity of $(8,930) and, after adding the profit of $18,540, the net improvement is $9,610.

The Budget Analyst's report, therefore, is overstated as follows:

Budget Analyst's	$27,846	@ 8.93%
Realistic level	9,610	@ 8.30%
	$18,236	overstatement by Budget Analyst's report

APPENDIX F

HOOD AND STRONG
CERTIFIED PUBLIC ACCOUNTANTS

555 California Street-Suite 3280, San Francisco, Ca. 94104
TELEPHONE 981-0705

September 7, 1976

MR. DANIEL MATTROCCE,
General Manager
San Francisco City and County
Employees' Retirement System
770 Golden Gate Avenue
San Francisco, CA 94102

Dear Mr. Mattrocce:

We have reviewed the proposal of the investment division of THE SAN FRANCISCO CITY AND COUNTY EMPLOYEE RETIREMENT SYSTEM (SFERS). The proposal would defer gains on the disposition of bonds with the resulting losses (or gains) being amortized over the maturity dates of the replaced bonds.

In the meeting of September 2, 1976 it was indicated that the proposed method was not in conformity with Generally Accepted Accounting Principles (GAAP). In further researching the matter, nothing has come to our attention that would change this opinion.

Under GAAP in existence at the present time, the only acceptable method for treating gains and losses on disposition of bonds is the completed transaction method now used by SFERS whereby gains and losses are included in the Statement of Changes in Net Assets Available for Plan Benefits at the time of disposition. This particular issue - deferral vs. completed transaction - is causing much discussion in the field of pension accounting and reporting. The Financial Accounting Standards Board, the Governmental Accounting Committee of the American Institute of Certified Public Accountants and The Auditing Standards Executive Committee of the latter organization all have had this topic under consideration as part of their overall consideration of the conceptual framework, methodology and implemental issues in pension accounting and reporting.

At the moment, none of these bodies have taken any position and therefore the completed transaction method continues to be the only generally accepted accounting principle in use for accounting for gains and losses on bond dispositions.

At the time the SFERS is proposing to begin changing the method to deferral (for the year beginning July 1, 1977) and certainly by the time the financial statements are to be issued for that year, most likely the matter will be resolved - either the deferral method will be considered to be GAAP or not.

If the SFERS changed its method of accounting to the deferral method and if at the time our report is issued GAAP still requires the completed transaction method, we would have to qualify our opinion. Without regard to any other matters to be considered in our opinion at the time of issuance, our report would have a middle paragraph such as the following:

> As more fully disclosed in Note X to the financial statements, during the year ended June 30, 1978, The San Francisco City and County Employees' Retirement System has changed its method of accounting for gains and losses on dispositions of bonds from the completed transaction method (recognizing profits and losses currently) to the deferral and amortization method. In our opinion, generally accepted accounting principles require recognizing such profits and losses currently.

The above paragraph assumes that "Footnote X" gives details of the two methods, the reason(s) for the change in method and discloses the effect on the financial statements as a result of the change.

The final paragraph (the opinion paragraph) of our report would then begin as follows:

In our opinion, except for the effects of not currently recognizing profits and losses from bond dispositions as discussed in the preceding paragraph, the aforementioned financial statements present fairly.....

We have not considered what, if any, effect the proposed change would have on achieving the actuarial assumptions required by the City Charter. At the proper time, we will confer with Counsel on this matter.

If we can be of any further assistance, please do not hesitate to let us know.

Very truly yours,

Harold A. Wagner

HHS:aro

cc: The Honorable John C. Farrell, Controller
City and County of San Francisco
City Hall
Civic Center
San Francisco, CA 94102

Mr. George B. Springman
Chief Investment Officer
San Francisco City and County
Employees' Retirement System
770 Golden Gate Avenue
San Francisco, CA 94102

AMENDED IN ASSEMBLY APRIL 16, 1974

CALIFORNIA LEGISLATURE—1973-74 REGULAR SESSION

ASSEMBLY BILL No. 3282

Introduced by Assemblyman MacDonald

February 28, 1974

REFERRED TO COMMITTEE ON RETIREMENT

An act to add Sections 31588.1 and 31589.1 to the Government Code, relating to County Employees Retirement Law of 1937.

LEGISLATIVE COUNSEL'S DIGEST

AB 3282, as amended, MacDonald (Ret.). County Employees' Retirement System.

Establishes in County Employees' Retirement System a deferred yield adjustment account and procedures for operation of such account.

Establishes a procedure for treating trades of bonds for similar bonds.

Applies only in counties where made applicable by majority vote of the board of ~~supervisors~~ *of retirement or the board of investment*.

Vote: majority. Appropriation: no. Fiscal committee: no. State-mandated local program: no.

The people of the State of California do enact as follows:

SECTION 1. Section 31588.1 is added to the Government Code, to read:

31588.1. There is hereby established in the County

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AB 3282

Employees' Retirement System a deferred yield adjustment account which shall be increased by the sale or disposition of any debt securities at less than book value and shall be decreased by the sale or disposition of debt securities at more than book value. At the end of each year, a portion of the balance of this account shall be offset against the investment income for that year. The annual portion of the balance to be offset shall be proportional to the reciprocal of the average remaining life of the bonds sold. The amount of this account shall be included in any accounting or actuarial computations or listing of assets. In any year in which the gains on the sales of debt securities exceed the discounts realized on the sales of such securities, the excess shall be used to reduce the balance of the account.

This section shall not be operative in any county until such time as the board ~~of supervisors~~ shall, by resolution adopted by majority vote, make the provisions of this section applicable in such county.

SEC. 2. Section 31589.1 is added to the Government Code, to read:

31589.1. There is hereby established for accounting purposes in the County Employees Retirement Law of 1937 the following procedure for treating a trade of bonds for similar bonds. Any loss or gain attributable to a trade of a like bond in the portfolio of any retirement system adopted pursuant to this chapter may be amortized over the life of the bond traded out by adding to or subtracting from the discount or premium attributable to the bond traded in. Like bonds for purposes of this section are considered to be bonds which will mature within seven years of the life of the bond traded out. Bonds to be traded must be of the first four grades. The fact that one bond may be a debenture and another a mortgage bond, or that the bonds may have different rates of return, shall not keep them from being like bonds.

This section shall not be operative in any county until such time as the board ~~of supervisors~~ shall, by resolution adopted by majority vote, make the provisions of this section applicable in such county.

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AB 3282 35 40

APPENDIX G

SOURCES OF INVESTMENT INFORMATION AND RESEARCH

Investment Advisor

Crocker Investment Management Corporation

Broad-based Economic Research

Peter L. Bernstein, Inc.
First Boston Corporation
Goldman, Sachs & Company
Merrill Lynch Pierce Fenner & Smith
Morgan Stanley
Oppenheimer
Salomon Brothers
Smith Barney Harris Upham
White Weld

Fixed Income Research

Bache Halsey Stuart
First Boston Corporation
Goldman, Sachs & Co.
Kuhn, Loeb & Company
Lehman Brothers
Paine Webber Jackson Curtis
L. F. Rothschild
Salomon Brothers
Shields Model Roland

Industry and Company Research

Bache Halsey Stuart
Blyth Eastman Dillon
Donaldson Lufkin & Jenrette
Drexel Burnham
E. F. Hutton
Kidder Peabody & Co.
Kuhn, Loeb & Co.
Cyrus J. Lawrence, Inc.

Industry and Company Research (continued)

William O'Neil & Co.
Paine Webber Jackson & Curtis
Loeb Rhoades & Co.
Robertson Coleman Siebel & Weisel
Reynolds Securities
L. F. Rothschild
Shearson Hayden Stone
Wainwright Securities
Wertheim & Co.
Wood Struthers & Winthrop

Investment Measurement Performance

Callan Associates

CROCKER INVESTMENT MANAGEMENT CORP.
44 MONTGOMERY STREET, SAN FRANCISCO, CALIFORNIA 94104

OMAR J. BRUBAKER
SENIOR VICE PRESIDENT AND
ECTOR OF PORTFOLIO MANAGEMENT

February 14, 1977

Mr. George B. Springman
Chief Investment Officer
Employees' Retirement System
City and County of San Francisco
770 Golden Gate Avenue
San Francisco, California 94102

Dear Mr. Springman:

As requested, we have reviewed the draft report of the Bureau of the Budget, Board of Supervisors evaluating the operations of the Employees' Retirement System. The report contains findings and recommendations which are directed specifically at two aspects of the investment program, on which we have prepared comments.

The first finding states (page 10):

"The Employees' Retirement System has maintained $156.4 million of prior years' lower yielding bond investments with yields as low as 2 3/4%. As a result of declining to sell such bonds at a loss and reinvesting the proceeds in higher yielding bonds averaging an 8.93% return in 1975-76, annual income of approximately $2.3 million was lost."

While we are all aware that there are some old, very low coupon bonds in the portfolio, to imply that there is $156.4 million of them is wrong. In fact, the composition of this $156.4 million as detailed in Appendix A of the Draft indicates that the analyst has included in his total, $25,650,000 par value of bonds which were purchased during the fiscal year ended June 30, 1976. These bonds were purchased at a cost of $25,139,646 and for an average current yield of 8.52%. In all, $51,900,000 par value of bonds were purchased in the last fiscal year, and it is correct that the average current yield on these purchases was 8.93%. But within this average are purchases ranging from U.S. Treasury Notes due in 1986 on a 7.88% basis to Trailer Train due in 1990 on a 10% basis. Actually the 8.93% average is skewed upward because we were taking advantage of unusual opportunities in the long Canadian Market. Of the year's purchases $9 million (17.3%) were Canadian issues yielding 9½ to 10%. It would obviously be imprudent to have the bulk of the holdings in Canadian issues.

In addition to questioning the use of 8.93% as a rate obtainable on reinvestment, we believe the analysis is in error when it applies the same rate to all bonds regardless of maturity or quality. For example, using Appendix A data for the bonds due in 1976-77 we find:

Par Value	Market Value	Current Income	Increase to Par	Total Return	Yield to Maturity
$3,372,222	$3,326,476	$147,684	$45,746	$193,430	5.8%

We don't believe it is realistic to think that we could sell these bonds on a 5.8% yield to maturity if the buyers of our bonds could buy other bonds at 8.93% for the same maturity. The same reasoning applies to all maturity levels. However, the draft analysis pays little attention to yield to maturity on the present holdings. This is the key number that must be used in making any bond swap. Of course, other factors such as quality, marketability, relative spreads, and type must also be considered, but yield to maturity is usually the starting point.

A sampling of the time periods and holdings used in Appendix A reveals the following average yields to maturity on the groups recommended for sale:

	Par Value	Mkt. Value	Current Income	Years To Maturity	Income To Maturity	Increase To Par	Total Return	Yield To Maturity
1985-86	$ 3,234,000	$2,694,970	$170,180	10	$ 1,701,800	$539,030	$ 2,240,803	8.3%
1995-96	10,000,000	9,629,563	799,088	20	15,981,760	370,437	16,352,197	8.5
2005-06	8,800,000	8,111,750	682,375	30	20,471,250	688,250	21,159,500	8.7

The above yields are understated to the extent that we have not assumed any return on the monies received from semi-annual interest payments. Again, it is extremely doubtful that the proposed sales, would have improved the overall return. In fact, of the $8,800,000 par value of 2005-2006 maturities recommended for sale, $6.5 million were purchased in 1975-76.

In summary, we believe the first recommendation of the report is based on faulty assumptions and would not produce the results claimed for it.

We believe the Budget Analyst should be reminded that as he said on page 8 of his introduction " - - - - the investment markets can and do change making it mandatory for the Employees' Retirement System to constantly monitor the various investment opportunities available to insure the highest returns to the City and County." It should be pointed out that this monitoring includes daily consideration of opportunities to improve the returns by analysis of swaps which are do-able in the prevailing markets. He might find it helpful to visit our offices to see the procedures and programs we use to analyze individual bond swaps.

We believe the analysis leading to the second recommendation is as faulty as the first. It says:

"The Employees' Retirement System had 23.7% of its total investments in common stock as of 6/30/76 or over 3% in excess of the 20.5% average of 18 other California Agencies. Based on the average yield of 8.93% in 1975-76 on its long-term bond purchases versus the system's yield on common stock of only 3.2%, the yield on bonds significantly exceeded the yield on stocks. By not having limited its stock investments to about 20% of its total investment portfolio, and correspondingly increased its investments in long-term bonds the Retirement System lost additional investment income of $1.4 million in 1975-76. While a one-time capital loss of $600,000 would have been incurred, the increased income of $1.4 million would be earned annually if the Retirement System reduced its investments in common stock and correspondingly increased its investments in long-term bonds."

Examination of Appendix D shows the use of inconsistent, non-comparable data to arrive at the average cited. The analysis averages data from different points in time. Ten of the 18 percentages used in the analysis were as of dates other than June 30, 1976. These should be thrown out as non-comparable. That leaves eight for comparison, a rather small sample to use for decision making.

	Yr. Fund Established	Yr. Stk. Purchase Began	Max. % Allowable In Stks.	Actual % Invested In Stks.
San Diego City	1911	1961	40	29.24
Los Angeles County	1938	1967	30	25.56
San Francisco City & Cty.	1922	1969	25	23.69
Santa Barbara Cty.	1944	1968	25	20.69
So. Cal. Rapid Transit	1959	1959	25	20.38
Los Angeles-Wtr. & Pwr.	1938	1968	40	19.61
Los Angeles - City	1937	1967	25	18.22
Ventura Cty.	1947	1968	25	16.72
San Mateo Cty.	1944	1969	25	7.00
Average				20.12

The range of these percentages is so wide and the sample so small that we doubt that it is indicative of anything other than some Retirement Boards are more positive toward common stocks than others. There is no way to know if San Diego City at 29% equities or San Mateo County at 7% is more correct in meeting their investment objectives. If we leave San Mateo County out, the average becomes 21.76%. We believe the analysis attempts give too much importance to what are really very imprecise numbers. For example, if a low cost stock is sold at a profit and the proceeds reinvested, the percentage in stocks at cost will immediately increase. Likewise, if a stock is sold for a loss and the proceeds reinvested, the amount in stocks at cost will be reduced. But in neither case will the market value of the stock holdings or the total fund be changed. We should also point out that none of the 18 Agencies surveyed have a maximum allowable in stocks of less than 25%.

We have explained our misgivings about using 8.93% as a reinvestment rate. We also believe it is incorrect to use the current yield (3.2%) on the common stocks as a measure of the return on stocks. Common stocks are purchased in the expectation of increased future dividends and increasing value. Appendix C, Analysis of Return on Investments, is really an analysis of cash return on book values. No mention is made of market values or even the return on market values. Using the Bache & Co. Portfolio Reports for June 30, 1974, 1975, and 1976 and the Transaction Reports for the fiscal years 1975 and 1976, we have calculated (Exhibit I) the total returns achieved, on a market value basis. On this basis, the common stocks returned 24% in 1974-75 and 10% in 1975-76 versus 13% and 10% on bonds. It could be argued that more should have been invested in stocks.

The draft report proclaims a loss of $1.4 million in income for the years, but says nothing about the common stock appreciation of $29.3 million in the past two years nor does it show that the bonds in the portfolio increased in value by $25.7 million in the same period. We know of no pension fund that measures its investment performance by using cash returns on book value. Time-weighted rates of return using market values are preferred.

On this basis, the Retirement System achieved the following returns:

	1974 - 1975			1975 - 1976		
	Bonds	Stocks	Total	Bonds	Stocks	Total
Income	7.63%	4.11%	6.96%	7.59%	3.36%	6.41%
Appreciation	4.95	20.02	7.77	2.83	6.68	3.82
Total Return	12.58%	24.13%	14.73%	10.42%	10.04%	10.23%

Based on our present favorable outlook for the economy and the expectation of high corporate earnings and dividends, we do not believe it would be in the best interest of the Fund to reduce common stocks.

In summary, we do not agree with the conclusions drawn or the recommendations made in draft report. Nor can we believe that their implementation would result in savings as great as has been projected. The whole analysis relies on the 8.93% reinvestment rate and that was unrealistic in 1975-1976 and is certainly unrealistic today.

Additionally, we believe the analyst may not have reviewed completely, the investment implications of the loss limits imposed on the System. We would have liked to have seen an actuarial analysis of the loss limits particularly in reference to item 2 of pg. 2 of the statement from the Certified Public Accountants.

It should also be noted that the examples used on page 11 to demonstrate how income could be increased, contain a significant error. The current income return on $3 million U.S. Treasury 4¼'s due 5/15/85 is $127,500 not $221,352 and if sold for $2,478,750 and reinvested at 8.93% the current income becomes $221,352, not $832,467. When corrected, it does not appear that the examples show the significant increase that was intended.

Sincerely,

OJB/gf

EXHIBIT I

CITY & COUNTY OF SAN FRANCISCO -- INVESTMENT RETURNS
Fiscal Years 1975 & 1976

	Notes	Total Bonds	Convertible Securities	Common Stocks	Total Portfolio
			Fiscal Year 1974 - 1975		
Market Value: End of Period	$27,050,000	$347,188,640	$ 8,181,600	$131,300,690	$513,720,930
Less: Begin Mkt Val	39,900,000	285,729,526	6,917,200	88,078,461	420,625,187
Purchases at Cost	- - - - - -	56,040,521	2,000,000	51,823,940	109,864,461
Add: Proceeds of Sales & Maturities	12,850,000	9,871,339	446,893	28,558,838	51,727,070
Net Appreciation (Deprec.)	$ - - - - -	$ 15,289,932	$ (288,707)	$ 19,957,127	$ 34,958,352
Interest & Dividends	3,034,162	23,567,893	587,350	4,098,933	31,288,338
Total Return	$ 3,034,162	$ 38,857,825	$ 298,643	$ 24,056,060	$ 66,246,690
Begin Mkt Val + ½ Net Purchases	33,475,000	308,814,117	7,693,753	99,711,012	449,693,882
% Return from Income	9.06%	7.63%	7.63%	4.11%	6.96%
% Return from Appreciation	- - - - - -	4.95%	(3.75%	20.02%	7.77%
% Total Return	9.06%	12.58%	3.88%	24.13%	14.73%
			Fiscal Year 1975 - 1976		
Market Value: End of Period	$18,600,000	$399,433,794	$13,450,800	$158,770,685	$590,255,279
Less: Begin Mkt Val	27,050,000	347,188,640	8,181,600	131,300,690	513,720,930
Purchases at Cost	- - - - - -	50,237,478	4,407,230	72,887,939	127,532,647
Add: Proceeds of Sales & Maturities	8,450,000	8,419,915	- - - - - -	54,799,944	71,669,859
Net Appreciation (Deprec.)	$ - - - - -	$ 10,427,591	$ 861,970	$ 9,382,000	$ 20,671,561
Interest & Dividends	1,333,187	27,925,542	751,850	4,714,717	34,725,296
Total Return	$ 1,333,187	$ 38,353,133	$ 1,613,820	$ 14,096,717	$ 55,396,857
Begin Mkt Val + ½ Net Purchases	22,825,000	368,097,421	10,385,215	140,344,687	541,652,323
% Return from Income	5.84%	7.59%	7.24%	3.36%	6.41%
% Return from Appreciation	- - - - - -	2.83%	8.30%	6.68%	3.82%
% Total Return 1975 - 1976	5.84%	10.42%	15.54%	10.04%	10.23%

Source: Bache & Co. portfolio reports for 6-30-74, 6-30-75, 6-30-76. Retirement system transaction reports for fiscal years 1975 and 1976. Interest and dividends are average of beginning and ending estimates as shown on Bache reports.

February 15, 1977

FINDINGS - PAGE 12

Reducing the current contingency reserve to the 2% requirement (a reduction of $3.8 million).

RECOMMENDATION:

"Reduce the System's contingency reserve by $3.8 million."

ANSWER:

After discussion with our consulting Actuaries, Coates, Herfurth and England and upon their advice, the sum referred to; namely, $3.8 million is required to be transferred to the Cost of Living Account to fund severely underfunded Cost of Living Benefits.

FINDINGS - PAGE 23

The methods used by the Employees Retirement System for estimating the City and County's (Employer) contributions to the Retirement Fund are inadequate. Improved estimating techniques would result in a one-time increase of Investment revenue of over $570,000.

CONCLUSION:

"The Employees Retirement System could increase its one-time net income by over $570,000 by revising the method it uses to estimate employer contributions to the retirement fund. This additional revenue would be available during the course of approximately one year and could produce a reduction in the employer contribution rate paid by the City and County during that period of time.

RECOMMENDATION:

"We recommend that the Employees Retirement System: (1) Base the estimate of employer contributions on 26 biweekly pay periods rather than on 12 monthly pay periods as is the current practice. (2) Base the estimate of employer contributions on the prior payroll rather than on the prior year payroll as is the current practice. This estimate should be derived by the Accounting Department adding the total wages and salaries paid from both the permanent and temporary payrolls for those positions which are subject to retirement. This estimate should be completed within approximately 5 days after the payrolls are released and the transfer of funds to the Retirement System should follow immediately.

ANSWER:

See attached memorandum from Savas Araboglou, dated February 15, 1977.

CITY AND COUNTY OF SAN FRANCISCO

SAN FRANCISCO CITY & COUNTY
EMPLOYEES' RETIREMENT SYSTEM
770 GOLDEN GATE AVENUE
SAN FRANCISCO, CA. 94102

February 15, 1977

TO : Daniel Mattrocce, General Manager

FROM : Savas Araboglou, Head Accountant

SUBJECT: Comments on Management Audit Report

The following comments are submitted in response to the Findings on Pages 23-26 of the Management Audit Report to the Finance Committee.

We have based our employer contributions on a prior year payroll base due to the lack of any up to date and reliable information. EDP has just completed the November 1975 activity month and at present they are fourteen (14) months behind in our work. This delay affects all our accounting cycle such as estimating employer contributions accurately. Since all of our information are processed by EDP, the only available data we have is the actual gross payroll of a year ago that was completed.

In addition, the first adjusting S.J.V. was processed on May 15, 1975, nine (9) months and ten (10) days after the original estimate was submitted. It was then too late to effectively change our annual estimate. Furthermore, pay raises for most City employees were held up for two (2) years due to litigations. As a result we estimated the salaries to remain the same. However, the Bang's suit retroactive wage increase was finally paid in June, 1975 and the Police and Firemen were paid their retroactive wage increase in December 1976.

Another major criticism in the Report is that we are missing two (2) extra bi-weekly pay periods in our estimate. That is not true as we do take into consideration the two (2) extra bi-weekly pay periods. We have on hand payroll conversion schedules that convert the 26 pay periods to a twelve (12) monthly basis. We cannot base our estimates of employer contributions on a 26 bi-weekly pay period while the rest of our accounting activity is on a monthly basis. I have been working with Date Processing and they will give us on March 1st a daily listing of all payrolls processed for that day. The report will give us the Dept. number, Payroll Period, Payroll number, Gross Compensation subject to retirement cost for both systems and employee contributions deducted for both systems. The daily report will give us the following results:

1. We will have on a daily and monthly bases Compensation subject to retirement costs for both system.

SAN FRANCISCO CITY & COUNTY
EMPLOYEES' RETIREMENT SYSTEM
770 GOLDEN GATE AVENUE
SAN FRANCISCO, CA. 94102

2. We will be able to correct our estimates from a historical base to a current monthly base.
3. Our estimates, subject to only slight modifications if any, will become actual costs.
4. We will be able to estimate with greater accuracy our monthly cash flow and predict with greater accuracy any surplus.

SAN FRANCISCO GENERAL HOSPITAL MEDICAL CENTER (SFGH) CHARGES RATES WHICH AVERAGE 9.5% LESS THAN THE RATES CHARGED BY ST. FRANCIS HOSPITAL. ST. FRANCIS IS UNDER CONTRACT TO INITIALLY TREAT CITY EMPLOYEES WHO SUFFER INJURIES ON DUTY. TREATMENT OF THE CITY'S EMPLOYEES AT SFGH FOR INJURIES ON DUTY WOULD RESULT IN ADDITIONAL REVENUES TO THE CITY. CONSEQUENTLY, THE WORKERS COMPENSATION DIVISION OF THE RETIREMENT SYSTEM COULD SAVE THE CITY AND COUNTY $170,000 PER YEAR BY RELOCATING FROM ST. FRANCIS HOSPITAL TO THE CITY-OWNED SAN FRANCISCO GENERAL HOSPITAL MEDICAL CENTER.

State Worker's Compensation Legislation, which became effective January 1, 1976, gave the injured employee the right to select his own treating physician after 30 days has elapsed from the date of injury. It seems probable that this legislation is only a forerunner of legislation whereby the employee will be granted immediate selection of his treating physician. The majority of our injuries (conservatively 50%) are back injuries which are treated conservatively, and hospitalization doesn't take place until the 30 days has elapsed.

The most important factor in reducing lost time, once an injury has occurred, is the selection of a competent physician, who is familiar with Worker's Compensation claims . In fiscal 1975-76 our total medical expenditures was $2.81 million, of which $436,000 was spent in hospital inpatient care at St. Francis Hospital. $1.4 million was the total hospitalization expense, so 2/3 of our hospital cost was spent at hospitals other than St. Francis. The reason for this is entirely due to our utilizing the most competent physicians available who place the patient in the hospital of their choice.

Taking the above into consideration it is our feeling that while San Francisco General Hospital was an appropriate facility in earlier less complex times, it would not be feasible to move now. It would seriously hamper our ability to adjust claims and the occupancy problem would remain the

*Comment of the Bureau of the Budget
We have deleted our finding and recommendation pertaining to this matter.

same. The chief reason that "Free choice of physicians" hasn't resulted in a chaotic situation to this point is simply that we have a modern, appealing facility injured employees are always treated courteously, and they realize they are treated by the best physician in the medical community. A return to "an older building" refers to the same locale and atmosphere that proved so unsatisfactory in the past, and seems a step backwards for the Compensation Division. There was great disatisfaction expressed by the employee groups, unions, individuals etc., which was alleviated by the move to St. Francis. Union advisers would easily use the recent free choice legislation, and make the suggested move a mistake. Furthermore the suggested move may not realize any savings.

In checking these figures it appears that at best these savings are questionable and could only be substantiated by an acutal cost comparison.

On its face it would appear that a move to SFGH would probably realize a minimal savings (1-2%) on moneys spent on x-rays. The General Hospital uses the 1969 RVS schedule at a $5/unit fee. The Director of Industrial Relations adopted the 1974 RVS schedule at a $7/unit fee (for x-ray).

Arbitrarily, taking lower extremity x-rays commonly taken in industrial injuries, myelograms, and low back x-rays a comparison of costs is shown in the following chart:

	S.F.G.H.	ST. FRANCIS	INDUSTRIAL FEE SCHEDULE
FOOT COMPLETE	$ 28.00	$ 33.00	$ 33.00
KNEE COMPLETE BILATERAL	64.00	67.80	75.50
LUMBO-SACRAL SPINE	65.00	63.40	69.65
MYELOGRAM			
ONE LEVEL	90.00	102.00	114.50
MULTI LEVEL	150.00	135.00	177.00

If the above figures represent a fair picture then a more exhaustive comparison

should be made.

Because of time limitations it is impossible to do any in depth study on billing. However an example of what would be done is to compare billings on comparable cases.

This example is that of chest pain necessitating hospitalization to rule out a myocardial infarct. Fortunately we were able to find a case where this example occurred where a patient was hospitalized at St. Francis and the other was hospitalized at San Francisco General.

The following chart shows the difference in charges that could be compared:

	ST. FRANCIS NOVEMBER 1976	SAN FRANCISCO COUNTY MARCH 1976
DAILY HOSPITAL SERVICE	$145/DAY	$160/DAY
CHEST X-RAY 2 VIEWS	31.40	30.00
ELECTROCARDIOGRAM	26.00	49.60
CPK ISOENZYMES	21.00	24.80
TOTAL	$223.00	$264.40

Daily Hospital service is shown in the chart below:

	ST. FRANCIS	SAN FRANCISCO GENERAL
MEDICAL-SURGICAL	$145/DAY	$160/DAY
INTENSIVE CARE	$350/DAY	$395/DAY
CORONARY CARE	$350/DAY	$350/DAY
BURN UNIT	$395/DAY	$433/DAY

Perhaps the biggest loss the City and County would sustain would be the cost of the emergency room. The St. Francis Emergency Room takes care of those City employees who seek initial treatment when the Franciscan

Treatment Room is closed. In fiscal year 1975 this amounty to 1904 visits. St. Francis charges the City a flat rate of $19/visit, San Francisco General charges $45.00/visit.

	ST. FRANCIS	SAN FRANCISCO GENERAL
1904	$19.00/Visit = $36,176.00	$45.00/visit = $85,680.00

It would appear from our quick analysis that moving the Compensation Division to SFGH would not provide the City and County with measurable savings. Should this move be contemplated, we would recommend that direct cost comparisons be made by matching bills between the two hospitals. Perhaps the example we used could with refinement be made into a model and a large enough sample developed to be statistically valid.

The most significant managment problem in the Worker's Compensation Division at present is our not being able to type and mail compensation checks from our office. This problem exists because of restriction placed on us by the Controller's Office. Unlike other disability insurance carriers, we must type disability rolls, which are sent to the Controllers Office, returned on an irregular basis,and there is normally a week delay in having the checks returned,therefore many employees receive their checks late. Thys system, 1) Ties up four people full time preparing rolls 2) Creates ill will on the part of those City Employees who are dependent on this check for sustenance. 3) Incurs a direct cost to the City by forcing us to pay 10% penalty on delayed payments.

We point out this problem because it wasn't included in the Audit report and is critical to our day to day operation.

FINDINGS - PAGE 31

The Workload of the Retirement Board is excessive, particularly in the area of disability hearings. While the Board heard and decided 298 cases from 1/1/76-6/30/76, it is estimated it will take the Board at least six months to eliminate its backlog of cases without considering the time required for new cases.

RECOMMENDATION:

"On November 12, 1976, the President of the Board of Supervisors requested the City Attorney to draft a charter amendment to provide for a hearing officer for disability cases. Our finding is consistent with the President's request. We recommend that the Board of Supervisors submit a charter amendment to the electorate to provide that the determination of disability benefit eligibility in individual cases be delegated to a professional hearing officer."

ANSWER:

This matter has already been addressed by the President of the Board of Supervisors, as he has requested the City Attorney to draft a charter amendment to provide for a hearing officer in disability cases coming before the Retirement System.

Regarding your comments under the cost benefit we would basically agree with the first three items. However, the fourth item which reads as follows: "It cannot be demonstrated by comparable experience but it is felt that the proportion of disability retirement applications approved will be reduced at substantial savings to the Retirement System and the City."

We question this statement regarding substantial savings since there is no evidence* to indicate that hearings before the Retirement Board as opposed to hearings by a hearing officer would cause a difference to occur with respect to the number of retirements granted or denied.

*Comment of the Bureau of the Budget
We concur with the Retirement System and have deleted this statement from our report.

February 15, 1977

FINDINGS - PAGE 34

Accounting and budgeting of disability payments is not uniform for various categories of City and County employees. As a result there has been inadequate disclosure of most of these payments which amounted to $5.1 million, including over $4 million for Police and Fire Department Uniformed Personnel in 1975-76.

CONCLUSION:

"The current budgetary treatment of disability payments for public employees makes it difficult to assess the true and accurate cost of public employee disabilities. This problem is particularly evident with respect to disability payments to uniformed public safety and MUNI personnel."

ANSWER:

The budgetary treatment of disability payments for public employees and the payroll application thereto is a matter that falls under the jurisdiction of the Controller of the City and County of San Francisco. While we agree with your comment entitled "Benefit" we feel that your recommendation should be directed to the Controller rather than the Retirement System.

FINDINGS - PAGE 37

Inconsistently applied medical standards used in the hiring and promoting of Police and Fire Department Uniformed Personnel could result in disability retirements for such employees being unnecessarily high. In 1975-76, San Francisco had 112 disability retirements as compared to 67 for the City of Los Angeles even though Los Angeles had nearly 3 times the budgeted positions of San Francisco.

CONCLUSION:

"Inconsistencies in medical examination standards can be a significant factor contributing to the relatively high rate of disability retirements which are granted to uniformed employees of the San Francisco Police and Fire Departments."

February 15, 1977

ANSWER:

We agree with your conclusion.

RECOMMENDATIONS: # 1

Under your caption "Recommendations" you state the following: We recommend that the Employees Retirement System, (1) "Request the Civil Service Commission in consultation with the Retirement System and the Police and Fire Departments to review and revise the medical standards for appointment and promotion of uniformed personnel with the objection of applying such standards on a consistent basis."

ANSWER:

This recommendation has been complied with. Over a long period of time considerable effort has been made by the Retirement Board and its staff regarding this matter. Evidence of our efforts are demonstrated in the attachments. Inquiries should be made by your office of the Civil Service Commission and the Police and Fire Commissions with regard to this item.

RECOMMENDATIONS: # 2

"Require that entrance examinations of uniformed personnel include x-ray examinations for women."

ANSWER:

This matter falls within the purview of the Civil Service Commission and your inquiries should be directed to them.

RECOMMENDATIONS: # 3

"Require that Worker's Compensation records be provided to Police and Fire Department Surgeons prior to promotional examinations."

ANSWER:

Worker's Compensation records have consistently been available to the Police and Fire Department Surgeons for whatever purpose they desire to use them.

February 15, 1977

RECOMMENDATIONS: # 4

"Require that promotional examinations for uniformed personnel include x-rays and electrocardiographic studies."

ANSWER:

The inclusion of x-rays and electrocardiogram studies are a responsibility of the Police and Fire Departments and possibly the Civil Service Commission. Therefore, your inquiries should be directed to those respective departments.

The Board of Supervisors passed an ordinance introduced by Supervisor Tamaras on 12/22/67 relating to this matter.

RECOMMENDATIONS: # 5

"Require that results of promotional examinations be measured against appropriately revised standards and that personnel failing to meet such standards not be certified for promotion."

ANSWER:

The matter referred to is under the jurisdiction of the Police and Fire Departments and your inquiries should be directed to those departments.

In general, as is evidenced by the attached communications, the Retirement System has, on repeated occasions, made representations to the Civil Service Commission, and the Police and Fire Departments regarding the above items One through Five.

FINDINGS - PAGE 41

It is projected that the Employer Contributions paid by the City and County for Social Security amounting to $12.5 million in 1976-77, will have increased to approximately $43 million by the year 2001. Although initially for the first seven years costs would increase by an average of $1.4 million annually, the City and County could save approximately $185 million over a 21 year period by withdrawing from the Federal Social Security System and establishing a supplemental retirement system for existing employees.

February 15, 1977

RECOMMENDATION:

"We recommend that the Board of Supervisors retain an actuarial firm to study the net potential savings which would result from the withdrawal by the City and County from the Social Security System and the implementation of a Supplemental Retirement System for existing employees. If the results of such a study validate our projected savings, it is recommended that the City and County take the necessary steps to withdraw from the Social Security System. The actuarial firm should consider any congressional action regarding the matter of Social Security for public jurisdictions."

SAVINGS:

"Implementation of this recommendation could result in reduced expenditures for Social Security costs of approximately $185 million over a 21 year period."

ANSWER:

Social Security is a very extensive and complicated matter as it relates to the public sector, particularly in light of current congressional studies and proposals. While the Retirement System has no responsibility or jurisdiction regarding Social Security as it applies to city employees we would most respectfully urge a complete and exhaustive study before concluding to apply for withdrawal. Such a study should employ among others, the services of actuaries, professionals in the benefits field* and others with expertise in the Social Security benefit structure, and also legislators at the Federal Level. Projected savings as indicated in your report may prove to be illusory, in fact, a precipitious decision with regard to withdrawal from Social Security may ultimately result in probable increased costs particularly in light of suggested proposals by the Social Security Administration and Congress.

Also, the possibility that partial funding of Social Security may, in the near future, draw upon the general revenues rather than exclusively on Social Security taxes would also pose some problems which should be dealt with.

While no mention was made of affairs dealing with the Actuarial Division said Division did render a memorandum which is included herein for your review.

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*Comment of the Bureau of the Budget

We concur that such a study should employ professionals in the benefits field and have revised our report accordingly.

February 15, 1977

MEMORANDUM

To: Daniel Mattrocce, General Manager

Subject: Comments on Management Audit as it relates to Actuarial Division.

1. A representative of the Budget Analyst office spent many hours in the Actuarial Division. We were aware that he was exploring certain phases of the operation but were quite surprised to find that no mention of our problems ever saw print in the report.

2. The obvious delay in processing of current retirement allowances should have been somewhere in the report. When the Audit was begun we were approximately 2¼ months behind and by January, 1977 we were 3 months late. Here is a basic, fundamental problem which was known and which we had hoped would have been examined by the Budget Analyst's audit with the hope that a recommendation for solution would be included. The problem was omitted from the report.

3. The Budget Analyst's office spent much time in review of the approximately $45,000,000 Police and Fire unfunded liability but no recommendation or mention of it appeared in the report.

4. Social Security coverage - The Management Audit contains the implication that Social Security coverage for city employees has been a drain on the taxpayers of the City ever since its inception. From 1960 to 1968 the city's cost for Social Security coverage was more than equalled by the offset against pension payments in effect at that time. For example in the first year of Social Security coverage the City's contribution to the program was $1.36 million whereas the reduction in contributions to retirement exceeded $4.0 million.

5. Other areas of lesser significance:

   A. Conversion of retirement roll and data reports to MSA.

   B. A better method of interviews and provision of information for members.

Edmond J. Walsh

EDMOND J. WALSH
Actuary

EJW:mm

February 15, 1977

In general we direct your attention to the fact that adoption of the recommendations contained in this report by the Board of Supervisors or any of its committees concerning the investment practices of the Retirement System constitute a violation of the provisions of Section 2.401 of the Charter. Such adoption would also be a violation of the provisions of Section 3.671 of the Charter, which provides that the Retirement Board "shall have exclusive control of the administration and investment" of the retirement fund.

Further with relationship to your Item Page 20,relative to your finding "The Employees Retirement System has maintained excessive cash balances of about $7 million daily with the Treasurer's Office. As a result of the Treasurer's restricted low yielding investments, earnings of approximately $196,000 were lost in 1975-76."

Efforts are being employed to find a means of reducing further the amount of cash balance in deposit with the Treasurer. Presently, we estimate that the $6.4 million balance in the Treasurer's Office can be reduced to approximately $2½ to 3 million. Further investigation and effort will be applied to this problem.

Please be advised that pursuant to Charter Section 6.311 the Retirement System shall take steps to request from the Treasurer, interest on those monies referred to in your findings, as they are creditable to the Retirement System and, therefore, will become available for investment by the Retirement System.

Finally, it is incumbent on our office to observe that an unreasonable time constraint was imposed on us to answer the findings of your report which concerned itself with those items of a very complicated nature. Furthermore, corrections deletions and adjustments to your original report, after its submission at your exit conference with us, have placed an unreasonable burden on the staff and our consultants to adequately and efficiently respond to your report.

In the introduction of your report you alluded to certain areas in the Retirement System Office to which no investigative findings have been addressed. These problem areas are of signal importance because of their impact on the effective and efficient operation of the Retirement System and bear a direct relationship to the findings and recommendations of your report.

Very truly yours,

DANIEL MATTROCCE
Retirement System
General Manager

DM:kg

RETIREMENT SYSTEM 6/30/76 BOND HOLDINGS WHICH WOULD PROVIDE INCREASED NET INCOME TO MATURITY IF SOLD WITH PROCEEDS REINVESTED AT AVERAGE ANNUAL RETURN OF 8.93%

Maturity Value	Cost	6/30/76 Price	6/30/76 Value	Annual Interest Income Current	Annual Interest Income @8.93%	Compound Incr. Interest to Maturity*	Capital Gain/(Loss)	Net Gain at Maturity
			1976-77					
$ 55,000 Comm Edison 3% 2/1/77	$ 55,000	97-3/4	$ 53,763	$ 1,650	$ 4,801	$ 1,575	$ (1,237)	$ 338
35,000 Emporium Cap.5-3/8 5/1/77	35,000	97-3/4	34,213	1,881	3,055	1,194	(787)	407
100,000 W. Pacific 4.55 3/1/77	100,000	99	99,000	4,550	8,841	2,145	(1,000)	1,145
161,000 Denver RioG 4-1/8 10/1/76	161,000	99-5/8	160,396	6,641	14,323	1,921	(604)	1,317
111,000 Denver RioG 4-1/8 4/1/77	111,000	99	109,890	4,579	9,813	5,325	(1,110)	4,215
151,000 Gt.North.4-1/8 3/1/77	151,000	98	147,980	6,229	13,215	3,493	(3,020)	473
49,222 KC So. 4.45 1/1/77	49,222	98-7/8	48,668	2,190	4,346	1,078	(554)	524
359,000 Louis.Nash. 3-7/8 6/1/77	359,000	97-3/4	350,923	13,911	31,337	17,730	(8,077)	9,653
294,000 Norfolk W. 4 5/1/77	294,000	97-3/4	287,385	11,760	25,663	14,146	(6,615)	7,531
234,000 Norfolk W. 8-1/4 4/1/77	234,000	100-1/2	235,170	19,305	21,001	1,725	1,170	2,895
300,000 Seaboard 4-1/4 2/1/77	300,000	98-1/2	295,500	12,750	26,388	6,819	(4,500)	2,319
300,000 Seaboard 4 2/1/77	300,000	98-1/2	295,500	12,000	26,388	7,194	(4,500)	2,694
527,000 So. Pac. 4-1/4 12/1/76	527,000	99-1/4	523,048	22,398	46,708	12,155	(3,952)	8,203
400,000 So. Pac. 4 3/1/77	400,000	98	392,000	16,000	35,006	9,503	(8,000)	1,503
148,000 So. Rwy. 4 10/1/76	148,000	99-5/8	147,445	5,920	13,167	3,623	(555)	3,068
148,000 So. Rwy. 4 4/1/77	148,000	98-3/8	145,595	5,920	13,002	7,205	(2,405)	4,800
$ 3,372,222	$ 3,372,222		$ 3,326,476	$ 147,68[illegible]	$ 297,054	$ 96,831	$(43,746)	$ 51,085

*Computed at 7 percent.

Maturity Value				Cost	6/30/76 Price	6/30/76 Value	Annual Interest Income Current	Annual Interest Income @8.93%	Compound Incr. Interest to Maturity	Capital Gain/(loss)	Net Gain at Maturity
						1977-78					
$1,000,000	US TreasNotes	8-3/4	8-31-77	$999,440(A)	101 7/8	$1,018,750	$82,500	$90,974	$ 3,793	$19,310	$ 22,543
50,000	CommEdison	3%	6-1-78	50,000	92-3/4	46,375	1,500	4,141	5,565	(3,625)	1,940
121,000	Dayton P&L	3%	1-1-78	121,000	93-5/8	113,286	3,630	10,116	10,073	(7,714)	2,359
100,000	DuquesneLight	2-3/4	8-1-77	100,000	96-1/8	96,125	2,750	8,584	5,936	(3,875)	2,061
150,000	Florida P&L	3-1/8	6-1-78	150,000	92	138,000	4,688	12,323	16,090	(12,000)	4,090
100,000	GulfStates UT	3	4-1-78	100,000	92	92,000	3,000	8,216	10,992	(8,000)	2,992
775,000	ILL.Bell Tel.	3	6-1-78	775,000	94-1/2	732,375	23,250	65,401	88,832	(29,000)	3,040
400,000	ILL. Power	3-1/8	2-1-78	400,000	92-3/4	371,000	12,500	33,130	32,040	(15,250)	1,054
200,000	Iowa P&L	3	2-1-78	200,000	92-3/8	184,750	6,000	16,498	16,304	(21,750)	10,858
300,000	MT.States Tel	3-1/8	4-1-78	300,000	92-3/4	278,250	9,375	24,848	32,608	(12,600)	5,024
160,000	Narragan El.	3	5-1-78	160,000	92-1/8	147,400	4,800	13,163	17,624	(15,625)	4,262
250,000	NewEng Tel	3-1/4	12-15-77	250,000	93-3/4	234,375	8,125	20,930	19.887	(6,300)	2,293
105,000	NY. Tel.	3-1/8	2-1-78	105,000	94	98,700	3,281	8,814	8,593	(44,375)	9,759
500,000	OHIO Power	3	4-1-78	500,000	91-1/8	455,625	15,000	40,687	54,134	(19,687)	1,092
250,000	Phita. EL.	2-7/8	2-1-78	250,000	92-1/8	230,313	7,188	20,567	20,779	(18,844)	9,396
335,000	TEXAS P&L	3	10-1-77	335,000	94-3/8	316,156	10,050	28,233	28,240	(6,375)	1,945
255,000	Waryland RR	5-1/2	8-1-77	255,000	97-1/2	248,625	14,025	22,202	8,320	(4,875)	1,252
100,000	W.Pacific	4-55	3-1-78	100,000	95-1/8	95,125	4,550	8,495	6,127	(13,975)	6,157
430,000	CB&Q	5-5/8	1-1-78	430,000	96-3/4	416,025	24,188	37,151	20,132	(13,750)	2,514
250,000	Clinch RR.	4-1/4	2-1-78	250,000	94-1/2	236,250	10,625	21,097	16,264	(7,240)	9,248
181,000	Denver,Rio G.	4-1/4	4-1-78	181,000	96	173,760	7,693	15,517	16,488	(4,750)	2,054
100,000	" "	4-1/8	1-1-78	100,000	95-1/4	95,250	4,125	8,506	6,804		
435,000	ST. North	4	6-1-78	435,000	93-1/2	406,725	17,400	36,321	39,875	(28,275)	11,600
150,000	" "	4-1/8	3-1-78	150,000	93-1/2	142,875	6,188	12,759	10,205	(7,125)	3,080
49,222	KC SO	4-45	7-1-77	49,222	97-3/8	47,930	2.190	4,280	2.126	(1,292)	834
49,222	KC So.	4.45	1/1/78	49,222	96-1/4	47,376	2,190	4,231	3,169	(1,846)	1,323
359,000	LouisNash	3-7/8	6-1-78	359,000	93	333,870	13,911	29,815	33,517	(25,130)	8,387
480,000	" "	4-1/8	3-1-78	480,000	95	456,000	19,800	40,721	32,492	(24,000)	8,492
335,000	Norfolk W.	4-1/8	8-1-77	335,000	96-1/2	323,275	13,819	28,868	15,312	(11,725)	3,587
294,000	" "	4	5-1-78	294,000	93-3/8	274,523	11,760	24,515	26,880	(19,477)	7,403
200,000	SO.Pac.	3-7/8	9-1-77	200,000	96-1/4	192,500	7.750	17,190	9,605	(7,500)	2,105
560,000	" "	3-7/8	1-1-78	560,000	94-5/8	529,900	21,700	47,320	39,790	(30,100)	9,690
234,000	Norfolk W.	8-1/4	4-1-78	234,000	100-1/4	234,585	19,305	20,948	3,462	$ 585	4,047
9,257,444				9,256,884(A)		$ 8,808,074	$ 390,856	$ 786,561	$ 662,058	(448,810)	$ 212,688 (A)

(A) Net gain includes calculation for original purchase at discount of $560.00

Maturity Value		Cost	6/30/76 Price	6/30/76 Value	Annual Interest Income Current	Annual Interest Income @8.93%	Compound Incr. Interest to Maturity	Capital Gain/(loss)	Net Gain at Maturity
				1978-79					
$1000,000FNMA	4-1/2 7-1-78	$ 897,500 (A)	94-3/4	$ 947,500	$ 45,000	$ 84,612	$83,481	$ 50,000	$ 30,981
169,000Cinnc. G&E	2-7/8 7-1-78	169,000	91	153,790	4,859	13,733	18,701	(15,210)	3,491
300,000Consol. ED.	3- 1-79	300,000	89-1/2	268,500	9,000	23,977	40,156	(31,500)	8,656
100,000Dallas P&L	2-7/8 4-1-79	100,000	88-1/8	88,125	2,875	7,870	13,392	(11,875)	1,517
310,000Duke Power	2-7/8 2-1-79	310,000	88-3/4	275,125	8,913	24,569	41,977	(34,875)	7,102
200,000No.StatesPwr.3	7-1-78	200,000	90-3/4	181,500	6,000	16,208	21,513	(18,500)	3,013
255,000W.MarilandRR	5-1/2 8-1-78	255,000	94-1/2	240,975	14,025	21,519	15,793	(14,025)	1,768
100,000W. Pacific	4.55 3-1-79	100,000	92-1/2	92,500	4,550	8,260	9,947	(7,500)	2,447
337,000Ches.&Ohio	5-1/8 4-1-79	337,000	93	313,410	17,271	27,988	35,098	(23,590)	11,508
325,000 CB & Q	5-5/8 1-1-79	325,000	94/3/4	307,938	18,281	27,499	24,715	(17,062)	7,653
250,000Clinch.RR	4-1/4 2-1-79	250,000	91-1/2	223,750	10,625	20,427	47,731	(21,250)	26,481
55 ,000 " "	5-1/2 8-1-78	553,000	98-1/4	543,323	30,415	48,519	38,153	(9,677)	28,476
181,000Denver &RioG.	4-1/410-1-78	181,000	92-1/2	167,425	7,693	14,951	19,460	(13,575)	5,885
181,000 " "	4-1/4 4-1-79	181,000	90-3/4	164,258	7,693	14,668	18,701	(16,742)	1,959
50,000 " "	4-1/8 7-1-78	50,000	93	46,500	2,063	4,152	4,402	(3,500)	902
100,000 " "	4-1/8 1-1-79	100,000	91	91,000	4,125	8,126	10,727	(9,000)	1,727
150,000St. North.	4-1/8 3-1-79	150,000	92	138,000	6,188	12,323	16,449	(12,000)	4,449
600,000 " "	4-1/8 4-1-79	600,000	91	546,000	24,750	48,758	78,628	(54,000)	4,628
180,000ILLCent	5-5/8 3-1-79	180,000	93-3/4	168,750	10,125	15,069	13,256	(11,250)	2,006
49,222 KC.SO	4-45 7-1-78	49,222	94	46,268	2,190	4,132	4,092	(2,954)	1,138
200,000Louis Nash	4-1/4 3-1-79	200,000	91	182,000	8,500	16,252	20,784	(18,000)	2,784
600,000Seaboard	5-3/8 3-1-79	600,000	94	564,000	32,250	50,365	48,570	(36,000)	12,570
120,000So	4-1/4 1-1-79	120,000	91-5/8	109,950	5,100	9,819	12,652	(10,050)	2,602
496,000 " "	9 6-1-79	496,000	102-3/8	507,780	44,640	45,345	2,308	11,780	14,088
234,000Norfolk W.	8-1/8 4-1-79	234,000	101-1/2	235,170	19,305	21,001	5,554	1,170	6,724
$7,045,222		$ 6,937,722 (A)		$ 6,608,537	$ 346,436	$590 142	$ 646,240	$ (329,185)	$ 214,555 (A)

(A) Net gain includes calculation for original purchase at discount of $102,500

Maturity Value			Cost	6/30/76 Price	6/30/76 Value	Annual Interest Income Current	Annual Interest Income @8.93%	Compound Incr. Interest to Maturity	Capital Gain/(loss)	Net Gain at Maturity
					1979-80					
$200,000 FNMA	4-1/2	7-1-79	$ 200,000	91-7/8	$ 183,750	$ 9,000	$ 16,409	$ 24,265	$(15,250)	$ 8,015
400,000Assoc. Tel	2-7/8	11-1-79	400,000	85-7/8	343,500	11,500	30,675	74,585	(56,500)	18,085
526,000BaltimoreG&E	4-7/8	6-1-80	526,000	89-1/8	468,798	25,643	41,864	73,413	(57,202)	16,211
50,000Dallas P&L	2-3/4	6-1-80	50,000	83-1/8	41,563	1,375	3,712	10,576	(8,437)	2,139
100,000DuquesneLight	2-5/8	10-1-79	100,000	85	85,000	2,625	7,550	19,316	(15,000)	4,316
200,000GulfStatesUt.	2-3/4	12-1-79	200,000	85-1/8	170,250	5,500	15,203	37,741	(29,750)	7,991
100,000Ill.Power	2-7/8	7-1-79	100,000	87-1/8	87,125	2,875	7,780	16,064	(12,875)	3,189
100,000Iowa-Ill.G&E	2-3/4	10-1-79	100,000	85-3/8	85,375	2,750	7,624	18,958	(14,625)	4,333
325,000Louis G&E	2-3/4	11-1-79	325,000	86-1/4	280,313	8,938	25,032	62,600	(44,687)	17,913
202,000NoStates Pwr	2-3/4	8-1-79	202,000	85-1/4	172,205	5,555	15,378	32,171	(29,795)	2,376
500,000Pac T&T	3-1/4	11-1-79	500,000	87	435,000	16,250	38,845	74,003	(65,000)	9,003
142,500So.BellTel.	3	7-1-79	142,000	90	127,800	4,260	11,413	23,426	(14,200)	9,226
2,000,000Comm.Credit	6-7/8	1-15-79	199,000 (A)	95-3/4	1,915,000	137,500	171,009	109,747	(75,000)	24,747
1,000,000 1stNat.Orgn.	6-3/4	2-15-80	995,000 (A)	95-1/2	955,000	67,500	85,281	69,166	(40,000)	24,166
100,000W. Pacific	4-55	3-1-80	100,000	89	89,000	4,550	7,948	13,217	(11,000)	2,217
553,000Clinch.RR	5-1/2	8-1-79	553,000	96-3/4	535,028	30,415	47,778	56,865	(17,972)	38,893
50,000Denver RioG.	4-1/8	7-1-79	50,000	89-1/2	44,750	2,063	3,996	6,330	(5,250)	1,080
100,000 " "	4-1/8	1-1-80	100,000	88-1/4	88,250	4,125	7,881	14,609	(11,750)	2,859
135,000 " "	5	5-1-80	135,000	90-1/4	121,838	6,750	10,880	18,691	(13,162)	5,529
180,000 IllCent	5-5/8	9-1-79	180,000	93	167,400	10,125	14,949	15,798	(12,600)	3,198
140,000So.Rwy.	4-1/4	7-1-79	140,000	90	126,000	5,950	11,252	17,364	(14,000)	3,364
140,000 " "	4-1/4	1-1-80	140,000	88-5/8	124,075	5,950	11,080	19,954	(15,925)	4,029
234,000Norfolk W.	8-1/4	4-1-80	234,000	100-3/4	235,755	19,305	21,053	7,911	1,755	9,666
7,477,000			$ 7,462,000		$ 6,882,775	$ 390,504	$ 614,632	$ 816,770	$ (579,225)	$ 222,545(A)

(A) Net gain includes calculation for original purchase at discount of $15,000

					1980-81					
800,000 FNMA	4-1/2	7-1-80	$ 800,000	89-1/2	$ 716,000	$ 36,000	$ 63,939	$ 126,433	$(84,000)	$ 42,433
700,000 FNMA	4.70	12-1-80	700,000	89-3/8	625,625	32,900	55,868	119,071	(74,375)	44,696
350,000DuquesneLight	2-3/4	8-1-80	350,000	81-3/4	286,125	9,625	25,551	72,078	(63,875)	8,203
250,000Texas El.	3-3/8	6-1-81	250,000	81-1/4	203,125	8,438	18,139	56,903	(46,875)	10,028
3,000,000B of A	6-5/8	12-1-80	2,986,200(A)	94-7/8	2,846,250	198,750	254,170	287,311	(139,950)	133,561
4,000,000 1st ChgoCorp	6-3/4	11-1-80	3,982,400(A)	95	3,800,000	270,000	339,340	359,942	(182,400)	159,[illegible]
365,000 CIAC	5	3-15-81	316,820(A)	89	324,850	18,250	29,009	55,777	8,030	15,627
325,000Ches&Ohio	5-1/2	8-1-80	325,000	91-1/2	297,375	17,875	26,556	39,288	(27,625)	11,663
135,000Denver Rio G.	5	11-1-80	135,000	89	120,150	6,750	10,229	18,008	(14,850)	3,158
135,000 " "	5	5-1-81	135,000	88-1/8	118,969	6,750	10,624	22,723	(16,031)	6,692
135,000 Norfolk W.	5	4-1-81	135,000	88-3/8	119,306	6,750	10,654	22,723	(15,694)	7,029
496,000 So Rwy	9	6-1-81	496,000	103-3/4	514,600	44,640	45,954	7,701	18,600	26,301
234,000 Norfolk W.	8-1/4	4-1-81	234,000	101	236,340	19,305	21,105	10,558	2,340	12,898
10,923,000			$ 10,845,420		$ 10,208,715	$ 676,033	$ 911,638	$ 1,198,516	$ (636,705)	$ 482,231 (A)

(A) Net gain includes calculation for original purchase at discount of $79,580

Maturity Value			Cost	6/30/76 Price	6/30/76 Value	Annual Interest Income Current	Annual Interest Income @8.93%	Compound Incr. Interest to Maturity	Capital Gain/(loss)	Net Gain at Maturity
					1981-82					
$1,500,000	FedNatMtge.	7-1/4 9-10-81	$ 1,559,062	98-1/8	$ 1,471,875	$ 108,750	$ 131,438	$ 133,080	$ (87,187)	$45,893
1,000,000	Int1BankRec.	4-1/2 2-1-82	1,000,000	85-1/8	851,250	45,000	76,017	203,812	(148,750)	55,062
848,000	Proct&Gamble	3-7/8 9-1-81	848,000	84-5/8	717,620	32,860	64,084	183,144	(130,380)	52,764
100,000	NY Tel. 3	7-1-81	100,000	81	81,000	3,000	7,233	25,181	(19,000)	6,181
234,000	Norfolk W.	8-1/4 4-1-82	234,000	101-1/4	236,925	19,305	21,157	13,521	2,925	16,446
$3,682,000			$3,741,062		$3,358,670	$208,915	$ 299,929	$ 558,738	$(382,392)	176,346
					1982-83					
$3,000,000	USTreasNotes	8-1/8 8-15-82	$ 2,967,188(A)	102-1/2	$ 3,063,750	$ 243,750	$ 273,593	$ 217,883	$ 96,562	$ 281,633
200,000	" "	8 2-15-83	200,025	101-1/2	203,000	16,000	18,128	17,144	2,975	20,119
300,000	NY.Sel.	2-3/4 7-15-82	300,000	76-1/2	229,500	8,250	20,494	89,393	(70,500)	18,893
500,000	Sears Acept.5	7-15-82	427,200(A)	86-1/2	432,500	25,000	38,622	99,453	5,300	31,953
309,000	Ches&Ohio	9-1/8 6-1-83	309,000	106	327,540	28,196	29,249	9,306	18,540	27,846
234,000	Narfolk W.	8-1/4 4-1-83	234,000	101-3/8	237,218	19,305	21,184	16,607	3,218	19,825
$4,543,000			$ 4,437,413		$ 4,493,508	$ 340,501	$ 401,270	$ 449,786	$ 56,095	$ 400,269

(A) Net gain includes calculation for original purchase at discount of $105,612

					1983-84					
$ 309,000	Ches&Ohio	9-1/8 1.6 84	$309,000	106-1/2	$329,085	$ 28,196	$ 29,387	$ 12,488	$ 20,085	32,573
234,000	Norfolk W.	8-1/4 4.1 84	234,000	101-1/2	237,510	19,305	21,210	19,974	3,510	23,484
$ 543,000			$ 543,000		$ 566,595	$ 47,501	$ 50,597	$ 32,462	$ 23,595	$ 56,057
					1984-85					
$ 3,000,000	USTreasBonds	4-1/4 5-15-85	$ 3,000,000	82-5/8	$ 2,478,750	$ 127,500	$ 221,352	$ 1,149,672	$ (521,250)	$ 628,422
2,000,000	Fed.NatMtge	8-20 7-10-84	2,000,000	101-1/8	2,022,500	164,000	180,609	174,153	22,500	196,653
2,000,000	IntBKReconst.	8-15 1-1-85	2,000,000	99	1,980,000	163,000	176,814	156,823	(20,000)	136,823
400,000	AT & T	3-1/4 9-15-84	400,000	73-1/2	294,000	13,000	26,254	138,975	(106,000)	32,975
309,000	Ches.&Ohio	9-1/8 6-1-85	309,000	107-1/8	331,016	28,196	29,560	16,708	22,016	38,724
234,000	Norfolk W.	8-1/4 4-1-85	234,000	101-5/8	237,803	19,305	21,236	23,654	3,803	27,457
$ 7,943,000			$ 7,943,000		$ 7,344,069	$ 515,001	$ 655,825	$ 1,659,985	$ (598,931)	$ 1,061,054

Maturity Value		Cost	6/30/76 Price	6/30/76 Value	Annual Interest Income Current	Annual Interest Income @8.93%	Compound Incr. Interest to Maturity	Capital Gain/(loss)	Net Gain at Maturity
				1985-86					
$ 500,000	US Treas Notes 7-7/8 5-15-86	$ 500,000	100-1/8	$ 500,625	$ 39,375	$ 44,706	$ 75,379	$ 625	$ 76,004
1,000,000	TVA. 4-40 11-15-85	989,440(A)	76-7/8	768,750	44,000	68,649	324,839	(220,690)	93,589
500,000	Armco Steel 4-1/2 6-1-86	500,000	80	400,000	22,500	35,720	186,928	(100,000)	86,928
1,000,000	US Steel 4-1/2 4-15-86	1,000,000	78-3/4	787,500	45,000	70,324	358,077	(212,500)	145,577
234,000	Norfolk W. 8-1/8 4-1-86	234,000	101-3/4	238,095	19,305	21,262	27,671	4,095	31,766
$3,234,000		$ 3,223,440 (A)		$ 2,694,970	$ 170,180	$ 240,661	$ 972,894	$(528,470)	$ 433,864

(A) Net gain includes calculation for original purchase at discount of $10,560

				1986-87					
$ 1,025,000	Shell 011 4-5/8 8-1-86	$ 1,025,000	78-5/8	$ 805,906	$ 47,406	$ 71,967	$ 347,288	$(219,094)	$ 128,194
				1987-88					
$ 3,007,748	TVA. 7-1/8 12-29-87	$ 3,007,748	91-5/8	$ 2,755,849	$ 214,302	$ 246,097	$ 547,834	$(251,899)	$ 295,935
				1988-89					
$ 481,000	Nat. Steel 4-5/8 6-1-89	$ 481,000	74-5/8	$ 358,946	$ 22,246	$ 32,054	$ 202,599	$(122,054)	$ 80,545
1,500,000	GMAC. 6-1/4 8-1-88	1,278,495(A)	84-1/2	1,267,500	93,750	113,188	356,361	(10,995)	123,861
1,919,000		$ 1,759,495		$ 1,626,446	$ 115,996	$ 145,242	$ 558,960	$ (133,049)	$ 204,406

(A) Net gain includes calculation for original purchase at discount of $221,505

				1989-90					
$ 1,000,000	Sta fferChe 4-1/2 12-1-89	$ 1,000,000	75	$ 750,000	$ 45,000	$ 66,975	$480,802	$(250,000)	$ 230,802
				1990-91					
$ 1,125,000	Cont'l 4-1/2 5-1-91	$ 1,125,000	71-3/4	$ 807,188	$ 50,625	$ 72,082	$ 553,833	$(317,812)	$236,021
1,000,000	Sun Oil 4-5/8 11-15-90	1,000,000	74-5/8	746,250	46,250	66,640	498,645	(253,750)	244,895
1,000,000	AT. & T. 3-7/8 7-1-90	1,000,000	69	690,000	38,750	61,617	529,263	(310,000)	219,263
$ 3,125,000		$ 3,125,000		$ 2,243,438	$ 135,625	$ 200,339	$ 1,581,741	$(881,562)	$ 700,179
				1991-92					
800,000	Sher. Wms 5.45 4-15-92	$ 800,000	78	$ 624,000	$ 43,600	$ 55,723	$ 334,632	$(176,000)	$158,632

Maturity Value			Cost	6/30/76 Price	6/30/76 Value	Annual Interest Income Current	Annual Interest Income @8.93%	Compound Incr. Interest to Maturity	Capital Gain/(loss)	Net Gain at Maturity
					1992-93					
$4,735,000	UsTreasBonds	4-1/4 8-15-92	$ 4,735,000	82-1/2	$ 3,906,375	$ 201,238	$ 348,839	$ 4,231,314	$(828,625)	$ 3,402,689
					1993-94					
					None					
					1994-95					
$3,000,000	Ford	9-1/4 7-15-94	$ 3,000,000	105	$ 3,150,000	$ 277,500	$ 281,295	$ 132,839	$ 150,000	$ 282,839
					1995-96					
$ 550,000	Intl.Bk.Reconst.	8-5/8 8-1-95	$ 550,000	99-5/8	$ 547,938	$ 47,438	$ 48,931	$ 57,502	$(2,062)	$ 55,440
2,000,000	Gen.Elec.	7-1/2 3-15-96	2,000,000	94-1/2	1,890,000	150,000	168,777	757,885	(110,000)	647,885
4,000,000	AlstonPur.	7-70 3-15-96	4,000,000	94	3,760,000	308,000	335,768	1,120,784	(240,000)	880,784
1,450,000	Travelers	8-70 8-1-95	1,450,000	99-1/4	1,439,125	126,150	128,514	91,048	(10,875)	80,173
2,000,000	West Elec.	8-3/8 10-1-95	2,082,000	99-5/8	1,992,500	167,500	177,930	420,980	(89,500)	331,480
$10,000,000			$10,082,000		$9,629,563	$799,088	$859,920	$2,448,199	$(452,437)	$ 1,995,762
					1996-97					
$ 170,000	PFEL	8-3/4 2-1-97	$ 170,000	100-1/2	$ 170,850	$14,875	$ 15,257	$ 16,905	$ 850	$17,755
3,000,000	GMA	7-3/4 8-26-96	3,000,000	94-5/8	2,838,750	232,500	253,500	887,777	(161,250)	726,527
1,000,000	AtlanticRich	5-5/8 5-15-97	1,000,000	79	790,000	56,250	70,547	662,003	(210,000)	452,003
$4,170,000			$ 4,170,000		$ 3,799,600	$ 303,625	$ 339,304	$ 1,566,685	$ (370,400)	$ 1,196,285
					1997-98					
					None					
					1998-99					
$ 3,000,000	GMAC	7-85 11-1-98	$ 3,000,000	92-7/8	$ 2,786,250	$285,500	$ 248,812	$ 644,624	$(213,750)	$ 430,874
2,000,000	Carnatin	8-1/2 5-1-99	1,995,000(A)	101	2,020,000	170,000	180,386	573,743	2,500	593,743
$5,000,000			$ 4,995,000		$ 4,806,250	$ 405,500	$ 429,198	$ 1,218,367	$ 25,000	$ 1,024,617
					1999-2000					
$ 900,000	CrownZell.	8-7/8 3-15-00	900,000	100-7/8	$ 907,875	79,875	$ 81,073	$ 69,095	$ 7,875	$ 76,970
1,500,000	ScottPaper	8-3/4 1-15-00	1,500,000	99-1/4	1,488,750	131,250	132,945	97,759	(11,250)	86,509
$2,400,000			$ 2,400,000		$ 2,396,625	$ 211,125	$ 214,018	$166,854	$(3,375)	$163,479

(A) Net gain includes calculation for original purchase at discount at $5,000

Maturity Value			Cost	6/30/76 Price	6/30/76 Value	Annual Interest Income Current	Annual Interest Income @8.93%	Compound Incr. Interest to Maturity	Capital Gain/(loss)	Net Gain at Maturity
2000-01										
$1,000,000	Wisc.P&L	8-7/8 10-1-00	$1,000,000	100	$1,000,000	$ 88,750	$ 89,300	$ 66,315	-	$ 66,315
500,000	Beth.Steel	8-3/8 3-1-01	490,000(A)	99	495,000	41,875	44,203	146,263	5,000	141,263
2,000,000	Cont.Oil	8-7/8 6-1-01	1,995,000(A)	101-1/2	2,030,000	177,500	181,279	247,520	35,000	277,520
2,000,000	Exxon Pipe	8-1/4 3-1-01	1,952,625(A)	98-7/8	1,977,500	165,000	176,591	727,925	24,875	705,425
2,000,000	Intl.Paper	8-85 12-15-00	2,000,000	101-1/2	2,030,000	177,000	181,279	268,725	30,000	298,725
2,000,000		8-40 3-1-01	2,000,000	99	1,980,000	168,000	176,814	553,527	(20,000)	533,527
2,000,000	HFC.	8-1/2 4-1-01	1,906,757(A)	96-3/4	1,935,000	170,000	172,796	183,135	28,243	118,135
$11,500,000			$11,344,382		$11,447,500	$ 988,125	$1,022,262	$ 2,193,410	$103,118	$2,140,910

(A) Net gain includes calculation for original purchase at discount of $155,618

2001-02

None

2002-03

$1,200,000	Dow.Chem.	7.40 7-15-02	$ 1,096,800(A)	91-1/4	$ 1,095,000	$ 88,800	$ 97,784	$ 639,495	$(1,800)	$ 534,495
695,314	TVA.	6-1/2 11-15-02	605,208(A)	86-1/4	599,708	45,195	53,554	729,094	(5,500)	633,488
$1,895,314			$ 1,702,008(A)		$ 1,694,708	$133,995	$ 151,338	$1,368,589	$(7,300)	$ 1,167,983

(A) Net gain includes calculation for original purchase at discount of $193,306.

2003-04

3,000,000	Borden	8-1/2 4-1-04	$2,866,680(A)	98	$ 2,940,000	$ 255,000	$ 262,542	$ 631,944	$ 73,320	$ 571,944
4,000,000	AT&T	7-1/8 12-1-03	3,990,000(A)	87-1/8	3,485,000	285,000	311,211	2,109,289	(505,000)	1,594,289
2,000,000	AtlanticRich	7-3/412-15-03	2,000,000	91-3/8	1,827,500	155,000	163,196	659,560	(172,500)	487,060
9,000,000			$8,856,680(A)		$ 8,252,500	$ 695,000	$ 736,949	$ 3,400,793	$(604,180)	$ 2,653,293

(A) Net gain includes calculation for original purchase at discount of $143,320.

2004-05

1,000,000	Beth.Steel	8.45 3-1-05	$ 990,000(A)	99-3/8	$ 993,750	$ 84,500	$ 88,742	$ 369-988	$ 3,750	$ 363,738
3,000,000	Dow.Chem.	8-1/2 4-1-05	2,980,250(A)	100	3,000,000	255,000	267,900	1,125,172	19,750	1,125,172
4,000,000	Rinn.Eng.	8 85 4-1-05	4,000,000	104	4,160,000	354,000	371,488	1,587,481	160,000	1,747,481
4,000,000	MobileAlaska	8 45 3-1-05	3,995,000(A)	98-3/8	3,935,000	338,000	351,396	1,168,434	(60,000)	1,103,434
2,000,000	Proct.	8-1/4 3-1-05	1,982,500(A)	99 5/8	1,992,500	165,000	177,930	1,127,789	10,000	1,120,289
2,000,000	Shell Oil	8-3/8 5-15-05	1,985,000(A)	100-5/8	2,012,500	175,000	179,716	428,097	27,500	440,597
3,000,000	Texaco	8-7/8 5-1-05	2,977,500(A)	101-1/2	3,045,000	266,250	271,919	514,606	67,500	559,606
1,000,000	MainCarb.	8-1/2 5-15-05	990,000(A)	100-1/8	1,001,250	85,000	89,412	384,826	11,250	386,076
3,000,000	AT. & T.	8 80 5-15-05	2,998,850(A)	103	3,090,000	264,000	275,937	1,083,586	91,150	1,173,586
2,000,000	Intl.Bell.Tel.	8 12-10-04	2,000,000	97-1/8	1,942,500	160,000	173,465	1,174,453	(57,500)	1,116,953
25,000,000			$24,899,100(A)		$25,172,500	$ 2,146,750	$2,247,905	$ 8,964,432	$273,400	$ 9,136,932

(A) Net gain includes calculation for original purchase at discount of $100,900

Maturity Value		Cost	6/30/76 Price	6/30/76 Value	Annual Interest Income Current	Annual Interest Income @8.93%	Compound Incr. Interest to Maturity	Capital Gain/(loss)	Net Gain at Maturity
				2005-06					
$1,000,000 Std. Oil(Cal)	8/34 7-1-05	$ 980,000(A)	101-1/2	$1,015,000	$ 87,500	$90,640	$ 285,034	$35,000	$ 300,034
2,500,000 Texaco	8-1/2 4-1-06	2,471,250(A)	98	2,450,000	212,500	218,785	617,554	(21,250)	557,554
3,000,000Union Oil	8-5/8 3-1-06	2,981,250(A)	99-1/2	2,985,000	258,750	266,561	737,769	3,750	722,769
2,300,000 SW.Bell	5-3/8 6-1-06	2,300,000	72-1/4	1,661,750	123,625	148,394	2,433,763	(638,250)	1,795,513
$8,800,000		$ 8,732,500(A)		$ 8,111,750	$ 682,375	$ 724,380	$4,074,120	($620,750)	$ 3,385,870
				2011-12					
$1,250,000 SW Bell	7-3/8 5-1-12	$ 1,092,477(A)	87-5/8	$ 1,095,313	$ 92,188	$ 97,811	$ 875,929	$ 2,836	$ 721,242
				2013-14					
$1,500,000 NJ.Bell	7-3/4 9-1-13	$1,450,620(A)	91-3/4	$ 1,368,750	$ 116,250	$ 122,229	$ 1,003,807	$ (81,870)	872,557
500,000 SW.Bell	7-5/8 10-1-13	453,340(A)	89-1/8	445,625	38,125	39,795	322,215	(7,715)	267,840
$ 2,000,000		$ 1,903,960(A)		$ 1,814,375	$ 154,375	$ 162,024	$ 1,326,022	$ (89,585)	$ 1,140,397
$157,705,950	TOTAL	$156,392,513		$148,375,067	$10,934,424	$13,249,895	$42,913,090	($8,017,426)	$33,441,140

(A) Net gain includes calculation for original purchase at discount of $ 67,500

(A) Net gain includes calculation for original purchase at discount of $157,523

(A) Net gain includes calculation for original purchase at discount of $96,040.

Plus gain at maturity to reflect average 6/30/76 purchase price of 96.797. $ 4,909,712

Total gain to maturity. $ 38,350,852

(A) Total net gain at maturity includes calculation for original purchase at discount of $1,454,524.

HOOD AND STRONG
CERTIFIED PUBLIC ACCOUNTANTS

555 California Street-Suite 3280 San Francisco Ca. 94104
TELEPHONE 781-0793

January 17, 1977

MR. JOHN T. WAGNER,
Associate Budget Analyst
Board of Supervisors
Bureau of the Budget
City Hall
San Francisco, CA 94102

Dear Mr. Wagner:

We are in receipt of your letter dated January 14, 1977 with "Attachment - Proposed Portfolio Capital Loss Offset, San Francisco Retirement System".

You are aware of the fact that we were engaged for the first time to audit the records of the SAN FRANCISCO EMPLOYEE RETIREMENT SYSTEM for the year ended June 30, 1976. Inasmuch as the audit report for the year ended June 30, 1975 has not yet been rendered by the auditors for that year, we have not performed any audit steps with respect to the year ended June 30, 1976 except the observation of the inventory of the securities portfolio. Our response to your letter therefore is based upon the data provided by you and the information contained in the audited financial statements for the year ended June 30, 1974 (especially as it relates to the purpose of the "Contingency Reserve").

As we understand your letter and attachment, the question is whether or not we would take exception in our opinion to the financial statements for the year ended June 30, 1977 if a capital loss of $8,624,978 realized in that year is also recognized in full in that year (assuming June 30, 1976 amounts were in existence as of June 30, 1977).

Based upon the assumptions set forth in your letter and attachment and based upon the following additional assumptions

relating to the financial statements for the year ended June 30, 1977 (as opposed to any future years) we would not take any exception in our opinion for the transactions in question if:

1. The full amount of the capital loss ($8,624,978) was reflected in the Statement of Changes in Net Assets Available for Plan Benefits. In effect, this means that the actual loss is not recognized directly to the reserve account but flows through the Statement of Changes in Net Assets Available for Plan Benefits to the reserve account.

2. No violation of any City Charter provision occurs as a result of the action taken and results generated. These would include, but not be limited to, rates of return on security transactions in any one year or limits of amounts that could be charged against the reserve account in any one year.

3. All required disclosure is made in the financial statements and footnotes in accordance with generally accepted accounting principles. This would include disclosure of this significant portfolio turnover and the reason why such action was taken.

Very truly yours,

Hood and Strong

HHS:aro

ANALYSIS OF RETURN ON INVESTMENTS

1968-69/1975-76

	Cost		Return On Investment*		Increase Which Would Have Resulted From Investing in Bonds Instead of Stocks	
	Stocks	Bonds	Stocks	Bonds	Return	Income
1968-69**	$ 9,784,863	$406,119,348	+0.22%	+4.45%	+4.23%	$ 413,900
1969-70	28,185,983	425,306,855	+1.64	+4.40	+2.76	777,933
1970-71	50,747,255	459,385,382	+3.46	+4.49	+1.03	522,697
1971-72	109,019,521	452,177,329	+6.48	+4.15	-2.33	(2,540,155)
1972-73	128,829,674	475,220,237	+3.48	+4.93	+1.45	1,868,030
1973-74	123,523,851	435,155,118	-1.40	+5.81	+7.21	8,966,070
1974-75	144,628,849	457,422,748	+1.84	+5.70	+3.86	5,582,674
1975-76	162,681,623	489,277,904	+3.15	+6.01***	+2.86	4,652,694
						$20,183,843

*Includes realized gains and losses.

**The Employees Retirement System held stocks for only two months in 1968-69. Excluding this year, the average returns were 2.65% and 5.08% respectively for the period 1969-70 through 1975-76.

***Bonds purchased in 1975-76 yielded an average of 8.93%.

Source: Controller's Annual Reports, 1968-69/1973-74
Bache & Co. Portfolio Transaction Report, 1974-75/1975-76.

COMPARATIVE RETIREMENT SYSTEM STOCK INVESTMENT DATA

CALIFORNIA JURISDICTIONS

FISCAL YEAR ENDED 6/30/76

	Year Fund Established	Year Stock Purchases Began	Maximum % Allowable In Stocks	Actual % Invested In Stocks	Yield On Stocks	Yield On Bonds
Alameda County (B)	1935	1970	25	18.23	2.96	5.83
Contra Costa County (B)	1945	1968	25	26.26	3.59	6.79
Fresno County (B)	1945	1968	25	22.33	2.92	6.40
Kern County (B)	1945	1967	30	20.69	3.53	6.27
Los Angeles - City	1937	1967	25	18.22	2.82	5.88
Los Angeles - Fire&Police(A)	1899	1963	50	32.25	3.28	7.80
Los Angeles - City Water & Power	1938	1968	40	19.61	3.62	6.15
Los Angeles - County	1938	1967	30	25.56	3.59	5.69
Oakland (A)	1951	1975	40	10.38	1.53	4.93
Orange County (B)	1945	none	25	none	none	6.79
Sacramento County (B)	1941	1968	25	19.67	2.72	6.69
San Bernardino County (B)	1946	none	25	none	none	6.34
San Diego City	1911	1961	40	29.24	1.18	7.44
San Diego County (B)	1939	none	25	none	none	6.74
San Mateo County	1944	1969	25	7.00	3.74	7.35
Santa Barbara County	1944	1968	25	20.69	3.78	6.79
So. Cal. Rapid Transit	1959	1959	25	20.38	2.68	6.57
Ventura County	1947	1968	25	16.72	3.35	8.04
Average				20.48	3.02	6.58
San Francisco County	1922	1969	25	23.69	3.17	6.07 (C)

(A) Fiscal year ended 6/30/75.
(B) Fiscal year ended 12/30/75.
(C) Based on entire bond portfolio. Yield on bonds purchased during 1975-76 was 8.93%.

RESULTS OF REDUCTION OF RETIREMENT SYSTEM'S STOCK PORTFOLIO TO 20% OF COST VALUE WITH REINVESTMENT IN BONDS (AS OF JUNE 30, 1976)

Total portfolio cost		$686,834,882
Common stock cost (23.7% of total)		$162,681,623
20% of total portfolio cost		137,366,976
Cost valuation of funds available for bond investment		$ 25,314,647
Common stock market value / Common stock cost	$158,770,685 / $162,681,623 =	97.6% market value of stocks compared with cost value
Cost valuation of funds available for bond investment		$ 25,314,647
		x 97.6%
Market valuation of funds available for bond investment		$ 24,707,095
Cost valuation of funds available for bond investment		$ 25,314,647
Market valuation of funds available for bond investment		$ 24,707,095
Capital loss on funds available for bond investment		$ 607,552
Annual income @ 8.93% average return on 1975-76 new bond purchases x $24,707,095 market valuation of funds available for bond investment		$ 2,206,344
Annual income @ 3.2% average 1975-76 return on existing stock portfolio x $24,707,095 market valuation of funds available for bond investment		790,627
Annual income increase after first year		$ 1,415,717
Annual income increase compounded @ 7%		$ 1,440,492
Less first year capital loss		$ 607,552
First year only income increase		$ 832,940

SHORT-TERM INVESTMENTS COMPARED TO
TOTAL ASSETS FOR 18 SELECTED PUBLIC
EMPLOYEE RETIREMENT SYSTEMS IN CALIFORNIA

Retirement System	Total Assets	Average Amount Invested In Short-term Paper	% of Total Assets
Los Angeles County**	$1,800,000,000	$ 10,000,000	0.56
Los Angeles City*	494,781,000	25,442,000	5.14
Los Angeles City - Water and Power*	431,969,000	2,500,000	0.58
Los Angeles City - Police and Fire***	393,653,000	31,087,500	7.90
San Diego County*	210,288,000	0	0.00
Alameda County*	168,970,000	10,000,000	5.92
San Diego City*	146,999,000	8,560,000	5.82
Orange County**	138,946,000	167,000 Est.	0.12
Contra Costa County*	129,865,000	1,000,000	0.77
San Bernardino County**	129,415,000	0	0.00
Sacramento County*	99,849,000	2,600,000 Est.	2.60
Kern County**	82,658,000	0	0.00
San Mateo County	82,285,000	3,071,000	3.73
Fresno County*	71,470,000	0	0.0
Ventura County*	66,622,000	1,500,000	2.25
Santa Barbara County*	54,121,000	0	0.00
Southern California Rapid Trans.*	47,600,000	2,000,000	4.20
Oakland Police and Fire***	46,549,000	1,000,000	2.15
Average	255,336,000	5,496,000	2.15
San Francisco	731,546,000 Est	21,060,000	2.88

*As of 6/30/76
**As of 12/31/75
***As of 6/30/75

ESTIMATE OF EMPLOYER SOCIAL SECURITY TAXES
PROJECTED FROM JANUARY 1, 1980 THROUGH JANUARY 1, 2001
(15,800 MISCELLANEOUS EMPLOYEES)

Calendar Year	Average Salary Subject To Social Security Taxes	City & County (Employer) Social Security Tax Rate	City and County (Employer) Social Security Taxes (Per Employee)	City and County (Employer) Social Security Taxes
1980	$ 15,198	6.05%	$ 919	$ 14,520,200
1981	15,958	6.30	1,005	15,879,000
1982	16,756	6.30	1,056	16,684,800
1983	17,594	6.30	1,108	17,506,400
1984	18,474	6.30	1,164	18,391,200
1985	19,398	6.45	1,251	19,765,800
1986	20,368	6.45	1,314	20,761,200
1987	21,386	6.45	1,379	21,788,200
1988	22,455	6.45	1,448	22,878,400
1989	23,578	6.45	1,521	24,031,800
1990	24,757	6.45	1,597	25,232,600
1991	25,995	6.45	1,677	26,496,600
1992	27,295	6.45	1,801	28,455,800
1993	28,660	6.45	1,849	29,214,200
1994	30,093	6.45	1,941	30,667,800
1995	31,598	6.45	2,038	32,200,400
1996	33,178	6.45	2,140	33,812,000
1997	34,837	6.45	2,247	35,507,600
1998	36,579	6.45	2,359	37,272,200
1999	38,408	6.45	2,477	39,136,600
2000	40,328	6.45	2,601	41,095,800
2001	42,344	6.45	2,731	43,149,800

PROJECTED NET SAVINGS BY WITHDRAWING FROM THE SOCIAL SECURITY SYSTEM AND ESTABLISHING A SUPPLEMENTAL RETIREMENT SYSTEM FOR EXISTING EMPLOYEES

Calendar Year	Additional Supplemental Retirement in Lieu of Social Security	City & County (Employer) Social Security Taxes Avoided	Net Estimated Savings or (Loss)
1980	$ 1,180,200		$ (1,180,200)
1981	2,512,200	$ 756,350	(1,755,850)
1982	3,715,200	1,603,429	(2,111,771)
1983	4,549,500	2,583,140	(1,966,660)
1984	5,179,800	3,622,590	(1,557,291)
1985	5,797,800	4,871,318	(926,482)
1986	6,558,000	6,141,607	(416,393)
1987	6,922,800	7,528,725	605,925
1988	7,117,800	9,037,761	1,919,961
1989	6,967,200	10,679,263	3,712,063
1990	6,405,000	12,461,439	6,056,439
1991	5,891,400	14,392,498	8,501,098
1992	5,101,800	16,490,016	11,388,216
1993	4,346,400	18,759,201	14,412,801
1994	3,442,200	21,215,718	17,773,518
1995	1,535,400	23,869,302	22,333,902
1996	18,429,600	26,737,030	8,307,430
1997	15,519,600	29,830,627	14,311,027
1998	12,190,800	33,168,850	20,978,050
1999	8,408,400	36,764,598	28,356,198
2000	4,128,000	41,064,272	36,936,272
			$185,678,253
Less estimated additional non-retirement benefit costs such as survivors and disability costs			(37,135,651)
Net estimated savings			$148,542,602

ORGANIZATION CHART
OF THE
EMPLOYEES RETIREMENT SYSTEM